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International Transfer Pricing: Privileges and Detriments

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Abstract- Transfer pricing has been representing a key position in the contemporary accounting world, that facilitates the Multinational corporates, to lower the burden of tax by transferring their products to the subsidiary nations or vice versa, to get the advantage of tax benefit with increased or decreased costs of sales. Multiple scenarios have been registered tracing out the implementation of transfer pricing by the companies to deceive the governments by paying less taxes. This research considers the transfer pricing policies of a parent company with its respective subsidiaries and the corresponding tax rates, and provide numerical evidence of how the transfer pricing is benefiting both parties, the MNC and the governments. Forecast of the financial statements for four years of Apple company are made by dividing the proportion of production of the company in two countries and the results exhibit a substantial margin for the companies implementing transfer pricing policies. Governments of the corresponding parties experienced a lot of difference in the tax revenue as well. Suggestions are provided that legal compliance by the organizations are required to balance the benefits for both the parties and the society.

Keywords- International Tax, Transfer Pricing

I. INTRODUCTION

1. Transfer Pricing

The phrase "transfer pricing" describes the established procedures and techniques used by multinational companies to define the prices for the exchange of commodities, services, and intangible assets-often based in different tax jurisdictions-between associated businesses within the same corporate group. The objective of this approach is to optimize the overall tax burden by guaranteeing compliance with tax legislation and distributing earnings and expenses among associated companies in an acceptable manner.

The major objectives of transfer pricing are to stop potential tax evasion or avoidance as well as maintain the integrity and fairness of financial reporting. This is especially crucial in an increasingly globalized economy where multinational companies conduct business internationally while adhering to different tax laws and regulations. To do this, companies have to follow the arm's length.

Problem statement

International transfer pricing is used to balance the profits among the parent company and the foreign subsidiaries. Initially this concept was applied to reduce the tax burden in the subsidiary country, so that the funds will be transferred to the parent company which gives huge profit margin. Moreover, it's also used to transfer the funds to the countries which has low tax slabs from that of high tax slabs. IFRS 17 provides the rules and regulations in adopting transfer pricing. Since the transfer pricing involve pricing of items that are being transferred within the company, intracompany transfers, it has been identified that the companies many times reported higher cost that the actual one just to provide less profit margin and to avoid high tax payment.

Sometimes this practice was identified as contradictory to the legal tax provisions of the governments. Numerous studies traced out the benefits of transfer pricing are not confined alone with tax reduction, rather it is extending its rule in assisting the management in multiple dimensions. Gradually, many circumstances have been observed the transfer pricing is implemented to avoid tax and few stating more benefits according to Udoayang, Joseph O., Akpanuko, Essien E, Asuquo, Akabom I in 2010.. Hinged upon the previous scenarios, this study will be designed to focus and analyze the advantages, implications, disadvantages to both the parties, Government and the Corporates.

Significance

The present study attempts to highlight the advantages that are caused by the transfer pricing. It considers the real attempts of two giant companies, globally, and effects of the transfer pricing on the cost and profits. The results obtained from this analysis will present a clear impact of the transfer pricing affects in a company's tax obligation in different levels of intercompany transactions. Previous studies did not analyze and provide the impact in clear numerical terms while this study overcomes this limitation. Moreover, the statistical techniques applied will explain the level of extent of impact. Furthermore, the research also considers the implications of transfer pricing rules by various countries.

Ultimately, this research on international transfer pricing makes a significant contribution to our knowledge of how multinational corporations function and how tax laws may be designed to support both fiscal integrity and economic progress on a worldwide basis.

Research Questions

- Does the international transfer pricing provide lone benefit of tax reduction?
- Is the determination of transfer pricing done in compliance with the legal provisions?
- What are the effects of transfer pricing on a company's financial statements?
- Why do governments implement specific transfer pricing regulations?
- Why do multinational corporations choose specific jurisdictions for establishing intra-company pricing structures?

Objectives

- To evaluate the reasons to choosing specific jurisdictions in establishing intra-company pricing structures by MNC
- To comprehend the implementation of transfer pricing is in compliance with legal provisions
- To determine the areas of accounting in which transfer pricing is related
- To explore the reasons of why the government, implement transfer pricing regulations
- To trace out the benefits of international transfer pricing in addition to tax reduction
- To emphasize the effects of transfer pricing on the financial statements

Hypotheses

- **H1:** Transfer pricing provides benefit for the MNCs in terms of tax reduction
- **H2:** MNCs obtain extended benefits from transfer pricing in addition to tax reduction
- **H3:** Legal provisions are considered during the implementation of transfer pricing
- **H4:** There is a significance of transfer pricing on the financial statements
- **H5:** Particular reasons influence the selection of jurisdiction in establishing transfer pricing

II. METHODOLOGY

The present study depends on the secondary data which is available from the websites of the companies that are considered for study. Few components of the financial statements such as Tax burden, Cost of sales, Profit are considered, and be forecasted as a percentage of sales that are transferred to the subsidiaries and the variations in the cost and profit will be determined for a period of four years.

Given the complexity of the topic, the research considers one MNCs, namely Apple Inc. with a subsidiary in Ireland, the Apple operations international Ltd.

The tax rates of the home country of the parent company (Unites states) and the tax rates of the subsidiary companies (Ireland) are taken into consideration to identify the differences between the cost of sales and profits.

Forecast of the company financial statements, the sales and the cost of sales will be made. It is done by considering various percentages of materials that are transferred, taking the tax rates into account. Suitable analysis tools in excel are applied on the obtained results to support and confirm the hypotheses.

Limitations

Since the area of study is related to the intercompany transactions, the detailed information about such transactions between the parent company with the subsidiaries, are not provided by any of the companies. Hence forecasts are made according to the available data from the financial statements and results are drawn upon.

The tax rates may vary from one country to other. Also, the legal implications vary for different economies. So, the impact of transfer pricing may not be generalized to all the companies in same way.

The data collected is for a limited period of time as it involves a lot of analysis for each portion of data. So, the amount of reliability on the results is comparatively.

III. REVIEW OF LITERATURE

Shantanu J. Pendse, 2012, highlighted that the tax liability is not the only important priority of the MNCs implementing transfer pricing.

John McKinley, October 1,2013, found that arm's-length payments made between related parties like a parent company and a controlled foreign corporation, presents a significant risk to multinational corporations' tax compliance and has significant ramifications for both tax planning and financial reporting

Katarina Zvarikoval and Erika Kovalova1,2020, found that lowering the level of tax burdens by using various strategies by business and maximizing the amount of taxes to be collected by the state, analyzing the legal documents and reviewing the existing context, conclude that the best interest of the state to define the transfer pricing precisely to prevent possible tax evasion.

Udoayang, Joseph O., Akpanuko, Essien E, Asuquo, Akabom I,2010, found that the companies and organizations should review regularly all their transfer pricing strategy provided that it is compatible or identical with the independent commercial concept (arm's length concept).

Helen Rogers & lynne Oats, 2021, they mentioned that the Arm's length principle (ALP) is the foundation of tax transfer pricing rules in the most of the countries and its used to calculate an arm's length transfer price or the price that would be applied if the same transaction were carried out by unrelated third parties.

Nguyen Thi Xuan Trang,2016, found that the outlay cost and the opportunity cost should be considered for determination of transfer price by taking into account the viewpoints of producing, buying sections and the company, satisfying the main objective of transfer pricing, which is goal congruence.

Richard Sansing,2014, emphasized on the basis of separate accounting, the income for the parent company will be in U. S and the foreign subsidiaries for the parent company determined separately and transfer price is causing change in the distribution of earning among the parent company and the related foreign subsidiaries.

Ruud De Mooij and Li Liu March 2018, found the principle that should be followed for determining transfer pricing is the arm's-length concept, which states that prices of goods and services offered to connected parties should be fair.

They mentioned that binding international coordination can prevent the negative impact on investment and the distortion of capital allocation that would be caused by the unilateral introduction of transfer pricing restrictions

Augustine E. Osho1, AbdulrahmanShaka,2022, contributed that the distribution of a company's worldwide taxable income among various taxing jurisdictions is directly impacted by transfer pricing also Nigeria's negative exchange rate and high inflation rate have an effect on the success of the country's food and beverage companies.

Shobhit Seth May 28, 2023, according to his research transfer pricing enables the determination of costs for the exchange of goods and services between subsidiaries, partners, or businesses under shared ownership that are a component of the same larger firm.

IV. DATA ANALYSIS

Analysis that has been done on the data to interpret the results. The analysis is done in two parts; first part which shows the performance of the company while the whole production and sale, is done in Ireland, and if the whole production and sale, is done in the United States by considering the variation in the corporate tax rates to trace the impact on the outcome of the company performance.

The second part of analysis is done by assuming if 100% of production is done in Ireland and 75% of the sale is done in the Ireland and the other 25% is done in United states, and by transferring the products to US from Ireland at a higher price, so as to understand the impact on the company due to the difference in the cost of sales impacted by the intercompany transactions, along with the difference in the corporate tax rates.

1. Analysis Considering Various Tax Rates

Table 1: EAT and EPS for various years at various tax rates

Year 2023			
Name of the component	21%	15%	12.5%
EAT	89,851,440	96,995,000	99,519,000
Basic EPS	5.71	6.16	6.32
Year 2022			
Name of the component	21%	15%	12.5%
EAT	94,091,370	99,803,000	104,215,125
Basic EPS	5.80	6.15	6.43
Year 2021			
Name of the component	21%	15%	12.5%
EAT	86,273,530	94,680,000	95,556,125
Basic EPS	5.17	5.67	5.72
Year 2020			
Name of the component	21%	15%	12.5%
EAT	53,001,890	57,411,000	58,704,625
Basic EPS	3.05	3.31	3.38

Interpretations

Decreasing the tax rate from 21% at the value of 89,851,440 to 12.5% at the value of 99,519,000 results in a significant increase in net income (EAT) and subsequently in Basic EPS. Lower tax rates allow the company to retain more earnings, which positively impacts profitability and shareholder returns.

The data shows that varying tax rates directly affect the company's net income. Lower tax rates at 12.5% lead to higher net income 104,215,125, while higher tax rates at 21% result in lower net income 94,091,370. This impacts the financial performance and profitability metrics of the company, such as earnings per share (EPS), which are influenced by the amount of earnings available after accounting for taxes.

We can notice that the lower the tax rate, the greater the company's net profit. the financial data of 2021 can reveal a significant impact of varying tax rates on the company's net income and earnings per share. Lowering the tax burden from 21% to 15% and subsequently to 12.5% led to successive increases in net income and enhanced earnings per share. These findings underscore the critical relationship between taxation policies and corporate profitability, emphasizing the potential benefits of strategic tax planning in maximizing shareholder value and overall financial performance.

These trends suggest that the company's financial performance improved steadily from 2020 to 2023, as reflected by higher earnings after tax and basic earnings per share figures. This could be interpreted as positive progress in the company's profitability and financial health over the specified period.

2. Analysis Assuming Different Level of Sales

Assuming the operating revenue is 30% high in the Ireland as it sold the material 25% of the over-all production to the to the United States branch, while other expenses didn’t change, under transfer pricing methods, as the tax is low in the Ireland, the following will be the income statement of the Ireland branch.

Table 2: The following table shows the key components that are to be considered after consolidating the above two income statements of both the countries after transfer pricing

Name of the component	2023	2022	2021	2020
Pretax Income	113736000	119103000	109207000	67091000
Tax Provision	15268767	15993708	14613770	8731120
Net Income to Common Stockholders	98467233	103109292	94593230	58359880
Basic EPS	9.99	10.17	8.98	4.98
Basic Average Shares	15744231	16215963	16701272	17352119

Table 3: The following table shows the comparison the components of the consolidated income statement before and after transfer pricing:

Year		2023	2022	2021	2020
Tax Provision	Before	16741000	19300000	14527000	9680000
	After	15268767	15993708	14613770	8731120
	Year	2023	2022	2021	2020
Net Income Common Stockholders	Before	96995000	99803000	94680000	57411000
	After	98467233	103109292	94593230	58359880
	Year	2023	2022	2021	2020
Basic EPS	Before	6.16	6.15	5.67	3.31
	After	6.25	6.36	5.66	3.36

Table 4: The differences between the net tax benefit and the net EPS before and after transfer pricing are as follows:

Year	2023	2022	2021	2020
Net tax benefit	1472233	3306292	- 86769.9	948879.9
% Difference of tax	9%	17%	-1%	10%
EPS	0.1	0.2	0.0	0.1
% Difference of EPS	2%	3%	0%	2%

Interpretations

The net tax benefit varied significantly over the past four years. In 2022, there was a substantial increase in the net tax benefit compared to 2021, with a 17% difference, indicating a significant tax advantage that year. Conversely, 2021 saw a small negative net tax benefit, reflecting a potential tax expense for the company. The year 2023 also demonstrated a positive net tax benefit but at a lower rate of 9% compared to 2022.

Regarding earnings per share (EPS), there were modest changes over the same period. The EPS experienced slight increases and decreases, ranging from 0.0% to 3%, indicating stable performance in generating earnings relative to shares outstanding.
In relation to transfer pricing adjustments, these fluctuations in tax benefits and EPS should be scrutinized to understand their impact on financial performance and tax liabilities. The positive net tax benefits in certain years might suggest effective tax planning strategies, potentially influencing reported earnings per share.

Summary of Findings

An appropriate determination of the transfer price of the products under the transfer according to the regulations provided the governing bodies, benefits to all the parties involved within and related to the transactions will gain benefits. The company performing the transfer pricing, the respective governments of the companies and other stake holders will also get the advantage. The transfer pricing directly has an impact on the components such as Cost of goods sold, taxation, revenue, net income, retained earnings and share holders' equity etc. It has its effect on the other components but not be same as the huge impact on the above-mentioned components, as it differs depending on the rates and general price index of the nations involved.

The main aspects which the companies consider for performing inter-company transactions are the cost to be allocated to the resources to produce and the corporate tax that is to be paid on the sale.

The study supports with the alternative hypotheses for the following:

- Transfer pricing provides the tax benefit for the MNCs.
- Corresponding MNCs obtain more benefits in addition to the tax benefit. Other benefits can be availed depending on the change in the taxation or the also change in cost of goods sold or other expense.
- The above reasons are in favor of the alternative hypotheses which says that there is a significant impact on the transfer pricing on the financial statements.
- Conflicting opinions were observed on the compliance of the legal provisions in implementing transfer pricing in the past researches and the present study as well.

Suggestions

Transfer pricing is considered as one the major strategies for the multi-National corporations to maximize its profit not only by depending on the customers, but also by altering the amounts to be incurred for the cost of production and the payment of taxes. This is an accelerating tool for the global trade as it involves enormous Multi National transactions within the subsidiaries of the company.

A keen forecast has to be made by considering each and every aspect of the company, the production, operations and financial components in detail, so that a comparison can be made in various cases which provides the actual profit a company could gain after implementation of transfer pricing process.

Companies should strictly abide by the rules that are levied by the governing bodies in determining transfer pricing, as it is not only going be a loss of revenue for the government but also manipulating reports can lead to a demise of the company and its stake holders. One of the examples is the Apple company case with Government of UK for having disputes in determining the prices. Unless the cost of export, import and distribution within the company and for the customers, is lesser than the amount that is going to be gains, there would not be any need of implementing the transfer pricing technique.

V. CONCLUSION

The present research study is conducted to trace out the advantages and disadvantages of the transfer pricing. A forecast has been made by calculating the changes in components of the financial statements at various tax rates and compared with each other. Major differences have been noticed in terms of income for the company. The wealth of the shareholders increased as the tax percentage decrease and vice versa. Cost of goods sold has also changed. Hence it can be said along with advantages to the MNC the government of the nation where the production has been done also enjoys the benefit of revenue as there is increase in the production in that respective country. On the other hand, the country from where the operations is transferred looses the proportion of production and that respective government looses the proportion of tax revenue.

There is a chance of manipulating by the actual value of the transferred products and deep evaluation and control over this process is required. Moreover, many cases have been identified as there are disputes between the governments and MNCs in reporting the financial statements, which when unsettled properly may lead to affect the shareholders and the other stakeholders. Upon the availability of the resources in various countries, the quality of production may also be altered from country to country.

Hence flawless transfer pricing, and its privileges can be obtained only by active and sincere role by all the parties contributing to and involving in the process.

Scope of Study

Many recent studies provide that international transfer pricing plays an important role in tax reduction of a company. This research dwells deeper in presenting the numerical perks as well by dealing with the real cases.

It covers various components of the financial statements where there is an impact of the transfer pricing. It also studies whether the legal compliances of few countries are justifying the actual amount of tax to be paid or far lesser than the required. This research contributes for the further studies to work on the actual data variances and impacts if more data would be available in the future.

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