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A Critical Appraisal of Transfer Pricing by Multinational Corporations

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Abstract

Purpose - This paper presents how Multinational Enterprises (MNEs) operate in different tax jurisdiction could decide on its transfer pricing strategy as the optimal solution to increase their global after tax income through transfer pricing and solve their related transfer pricing issues related to distribution cost, consumer, and wholesale vendor. It has been strategy issues for an MNEs to locate its tax basis of wholesale vendor and buyer in a jurisdiction where effective rather low

Research design, data, and methodology - The collection of information and data for this research project gathered from various sources of secondary data. The findings of these relevant research topic article and journal were the main source of references for this research project

Results - The achievement of management's operational and financial objectives depends on transfer pricing policies availability that is consistent and supports both vendor, wholesaler, distributor and ensuring sufficient documentation and data is available to support the application and arriving at the arm length.

Conclusions - The study concluded with an emphasis on the importance of web-designed information about international taxation rules and transfer pricing policy and pricing agreement among wholesale vendor and whole buyer around the world.

Keywords: Transfer Pricing, Whole Sale Vendor and Buyer, Multinational Enterprises, Taxation Issues.

JEL Classifications: G00, L00, M20, M30.

1. Introduction

Transfer pricing is a critical international taxation issues for both MNEs and multi-jurisdiction. Transfer pricing is the most important taxation issue faced by MNEs in 1990 (Ernst & Young, 1995). The problem of finding the optimal transfer level in business world has become a crucial issue for management level. This MNEs transfer pricing issues have showed proof that there were growing number of interest in forming approach as solution to this transfer pricing issues. Transfer pricing is a way of setting the price charged on inter-company trade in goods, business services or intangibles. There have been various type of transfer pricing methodology, legislation regulation, transfer pricing policy, documentation, international taxation guidelines and programs as an establishment of transfer pricing compliance requirement for MNEs and evade double taxation, scrutiny and monetary penalties as well as able to satisfy the arm's length standard. Though MNEs still engaged with transfer pricing manipulation and create jurisdiction problem for domestic governments and limits their effectiveness in taxing MNEs.

1.1. Research Problem

The solution to transfer pricing issues depends on judgment of management's operational needs and financial objectives between MNE's and motif of tax authorities. The transfer price that was chosen by MNEs should meet arm's length price as pricing rules, practice and approach and requirement that set by Multi-jurisdiction. The research problems of this study are summarized as below:

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a) Lack of availability of internal tax expertise in implementation of a strategy transfer pricing planning as well to develop creative and practical solution.
b) Lack of information on tax issues, regulation, rulings, priority and pricing methods both by vendors and buyers, transfer pricing penalties, documentation requirement, return disclosure, related parties disclosure and specific programs in other countries. This includes changes of tax rules and requirement with little advance notice.
c) Prescriptive guidelines like OECD that not considered as a practicable option that attempt to deal with every transfer pricing issues. Thus establishing appropriate transfer pricing for tax purpose involves the application of judgment which often depends on tax payable both by Vendor and Buyer.
d) Lack of understanding of cross-border logistics dealing between the associated enterprises in the context of the tax payer's business.
e) Problem selecting and determining the most appropriate methodology based on the facts and circumstances of particular case. This includes ensuring sufficient documentation both by vendors and buyers and data is available to support the application.

1.2. Objectives of the Research

The objectives of the research include:

a) To find the optimal transfer pricing solution as better judgment and implementation of transfer pricing method as compliance to arm's length requirement of both vendor and buyer.
b) To analyze the factors motivate transfer price manipulation in Multinational Enterprises (MNEs).
c) To investigate the benefits derived from Advance Pricing Agreement (APA) program, which was introduced by IRS as tool to resolve the transfer pricing issues.
d) To discuss the application of an arm's length standard as approach to resolve most of transfer pricing issues.

1.3. Scope of the Study

Transfer pricing has become the most important international taxation issues for both MNEs and nation states in the 1990s. The economic issues and the increase in the relevance of transactions subject to transfer pricing, has become a central concern in MNE operation and inter-jurisdictional arrangements. This study on transfer pricing focus on a MNEs strategic issues to minimize its tax liabilities and evade increased surveillance by tax authorities as well as tax audit, penalties and scrutiny. The solution for this transfer pricing issues has led government to response with its transfer pricing regulations. It includes use of transaction based methods, transfer pricing policies, inter-company transfer pricing documentation and penalties, guidelines, usage of arm's length standard, programs and other alternative methods that would benefits both MNEs and government.

2. Literature Review and materials and methods

2.1. Transfer Price and Documentation

Effective transfer pricing policy and proper documentation can benefit multinational corporations(Dean et al., 2009). Daniel Warr et. al. (2002) emphasized on documentation that should be maintained by UK company in order to minimize the risk of penalties being applied on vendors or buyers by the inland Revenue as result of any of the company's transfer pricing practices. It emphasized on document taxpayers are expected to prepare, those which they are required to retain and one which are not required, also emphasize on contemporaneous preparation of the relevant documentation that should justify the price charged. They mentioned that the transfer pricing should contain an overview of the business of the company, including an analysis of the economic and legal factors that affect the pricing of related party transaction (vendor and buyer), together with an organization structure. Therefore such information will assist in giving the Inland Revenue an understanding of the transfer pricing policies adopted by the company and demonstrate the commitment of the company to adhering to the law in this area. The author suggested that both vendor and buyer companies must maintain the documentation file to avoid harsh penalties if it was not in position to justify its methodology in documentation. Survey reveled that few firms of vendors and buyers set their transfer pricing strategy to minimize tax payments, but majority of firms focus on tax compliance(Klassen, Lisowsky, & Mescall, 2016).

2.2. Transfer Price and Inter Group Trading

Palmer (2002) discussed that in any decentralized but interdependent organization there are problems agreeing transfer price for inter-group trading. He also described the problems, by allowing parts of organization autonomy over freedom to make own decision which are not in the best interests of the organization. The problem include, by rewarding performance based on one criterion the organization causes vendors and buyers to lose sight of the other goals which the organization wishes to strive towards. The author highlighted the three objectives for any system of transfer pricing should be:

a) Encourage vendors and buyers to make decision, which are conducive to the long-term health of the

whole organization.

b) Assist senior management to assess the performance of the units within the organization.

c) Promote autonomy within the separate units of the organization to allow informed decision making to be made at local level.

The system was often used to assist with measuring the performance of the managers of units within the organization. It is unlikely that any of the transfer pricing can satisfactorily achieve even the main objectives simultaneously. Therefore, these three key points must be made:

a) The transfer price should never be used to set selling prices.

b) Whatever price is agreed will not affect profit for the entity.

c) Performance of both vendor and buyer can be measured against the agreed price. The amount of profit cannot be compared across entities unless constraints are allowed for.

The author further discussed the three main methods of transfer pricing in common use. These methods include market price, cost, and cost plus. He also mentioned some of the advantages and disadvantages of each method. The article discussed a basic understanding of key financial concepts to assist managers in their work. It also failed to discuss about effectiveness of the transfer pricing system measuring the performance of the managers of units within the organization. Though the aim of transfer pricing is to maximize the value of the corporation, but the internal goal of transfer pricing system include performance evaluation of subsidiaries and their managers(Abdallah, 2004).

2.3. Transfer Pricing Architect

Touche (2001) discussed that transfer-pricing architect is the comprehensive transfer pricing documentations and analysis software designed to help organizations manage transfer pricing risk. The system guides vendors and buyers through building a comprehensive documentation report to establish a position for transfer pricing policies and plan transfer pricing strategies. Global transfer pricing solution combines a proven transfer pricing documentation and analysis system, Transfer pricing Architect, with the tax and economic expertise and together the two simplify the transfer pricing process, allowing tax departments to focus on the issues rather than on the creation of the study. The article also discussed about the transfer pricing services that included with TPA and client (vendors and buyers) benefit from having access to a worldwide network of experienced transfer pricing professionals, whether the client performing the first pricing study in-house or sophisticated tax department with internal resource. The article further emphasis the benefits of TPA. It helps to avoid costly Penalties for Lack of documentations. TPA guides users through each step of building a comprehensive transfer pricing documentation report to avoid documentation penalties. TPA also improves the Analysis of data, with TPA user can quickly identify trends and issues by analyzing data in different view. The system has built-in checks for identifying discrepancies in comparable and financial data and performs a variance analysis across databases to detect differences in the numbers. Besides that TPA assists in management and Economic decision making. TPA's flexible methodologies aid management in determining transfer price for tax and other purposes such as global reengineering strategies.

Ernst and Young (1999) had discussed about the vendor and buyer organization that operate in different tax jurisdictions could have many strategic opportunities to increase their global after tax income through transfer pricing. This strategy involved shifting of functions and risks among vendors and buyers, pricing of inter-company services and transfer of intangible property to minimize the reporting of income in high-tax or tax-inefficient locations. The author highlighted that one of the key issues in a transfer-pricing analysis was the balance between tax and operational goals. Thus, meeting this balance requires a proper procedures and documentation that will ensure the organization was in compliance with regulatory requirements of various taxing jurisdictions. This also includes accurate measurement of each related entity's financial performance through the establishment of arm's-length inter-company prices removes artificial distortions between functions and compensates key functions according to their market value and economic contributions. The author further suggested that a well-designed transfer-pricing methodology will help the vendor and buyer to reduce its effective and may also lead to more accurate measurement of the financial performance of the various business units vendor and buyer. In additional, transfer pricing policies that are consistent with and support the business operation and financial objectives.

O'Brien (2000) outlined the record keeping requirements that imposed by the IRS as far as US corporations are concerned. The author commented to avoid penalties from IRS the taxpayer's could establish the transfer price was determined in accordance with the regulations under Section 482, and the taxpayer has detailed documentation supporting the transfer price methodology. The pricing methodologies specified in the regulations under Section 482 include, among others, the comparable uncontrolled price method, resale price method, the cost-plus method and the comparable profits method. The author further mentioned the regulation under Section 6662 require a taxpayer compile and maintain detailed documentations setting forth the transfer pricing analysis undertaken by the taxpayers. Additionally, the documentation must establish that given the

available data and the applicable pricing methods, the method chosen by the taxpayer provided the most accurate measure of an arm's length result. The author also stressed the affected taxpayers must compile the required documentation and ensure its quality and scope. In addition, taxpayers may enter into an Advanced Pricing Agreement (APA) with IRS that establishes a transfer pricing method as the expected result. The principle purpose and benefit of an APA is the certainty offered to the agreement that its transfer price will not be challenged in the course of the future tax exam, assuming the full pattern has not materially changed.

2.4. Transfer Pricing and Arbitrage

Rosenbloom (2000) examined one example of arbitrage stemming from differences between US transfer-pricing rules and the rules that other jurisdictions apply to evaluate transfer pricing. The author also discussed about the United States should find a problem in this arbitrage. On the assumption the problem does exist. The author examined what the United States might choose to do about it, given other tax policy considerations. The author noted that Congressional efforts to deal with arbitrage have been incoherent, that policies articulated by the treasury and the Internal Revenue Service in regard to arbitrage have been inconsistent, and that outrage directed at parties taking advantage of arbitrage opportunities was misplaced. The author further demonstrated through single specific example how arbitrage possibilities can arise as a byproduct of a wholly desirable or at least arguably wholly desirable tax policy initiative that such possibilities are in other words, inevitable, indeed as common beach sand and probably just as difficult to eliminate. Further, the article discussed those parties of vendor and buyer making advantage of arbitrage possibilities may be engaging in activities no more questionable than accepting clearly expressed invitations to reduce their tax liabilities, and that threatening penalties for doing this or otherwise attempting to dissuade such parson from employing arbitrage was both fruitless and silly. Moreover, any attempt to fix the arbitrage problem was almost assuredly going to carry a cost in term of other tax policy objectives.

2.5. Interdivisional Transfer Pricing Mechanism

Deciding a proper transfer price is of significance to a firm made out of divisional benefit focuses since it fundamentally influences profit center and ultimately firm's profit(Liu, Zhang, & Tang, 2015). Ian Springsteel (1999) mentioned that a second managerial system helps some company's measure internal profits better when tax-based transfer prices fall short. He discussed that to solve this inconvenient problem companies need to control interdivisional transfer pricing mechanism, that based on various financial and tax-accounting reporting and also forms the backbone of the divisional bonus system. The author highlighted traditional tax-based transfer pricing for management purpose should be changed. This is because the standard transfer pricing may encourage the wrong behavior by vendors and buyers who aim for tax profitability. The distortion in various tax and accounting codes may prevent the traditional numbers from reflecting the realities of inter-company transactions(Cools & Slagmulder, 2009). In addition, using only the tax-based internal prices may create an artificial rigidity in internal accounting, depriving marketing people of the freedom to establish prices that reflect realistic profit margins. James and Hines (1990) discussed the current interest in revising the regulation that governs the taxation of Multinational Corporation. This interest aroused in part from the perception that large integrated firms avoid taxes by manipulating the transfer pricing that was used for trade between their own affiliates located in countries with different. The author emphasized here was strong evidence of transfer pricing manipulation under current rules and scope of the potential problem was quite large. The author the elaborated the challenge to construct a system that provides efficient incentives for resource allocation by integrated international firm while preserving the location of purely national profits. The government also argued this solution corresponds to concept of income division which government had tried to employ in broader context. The author emphasized that without strong enforcement efforts firms will always be able to evade some taxes with illegal bookkeeping.

2.6. Double Taxation Relief among vendors and buyers represented by MNEs

Neighbour (2002) discussed how the arm's length principle could help countries avoid double taxation when conducting transaction with MNEs. He emphasized the importance of transfer pricing because of globalization and rise of MNEs trade. He further explained the purpose of allocation of profits to tax and financial difficulties to subsidiary company if the parent company pays below the local market price even though decent profit margin when the sale is completed. The author emphases that transfer pricing would determine how much profit the company reports and how much local tax it pays. Transfer pricing are used to help to help MNEs to identify those parts of enterprise that are performing well. MNEs could suffer double taxation on same profit without a proper transfer pricing. The author highlighted that to avoid such problem the current OECD international transfer pricing guidelines which are based on the arm's length principle transfer price should be used in order to have same transfer price for two independent vendor and buyer companies and not one part of the same corporate structure. The MNEs could reduce transfer-pricing issues through asking the two tax authorities

to reach agreement on what the arm's length principle and avoid double taxation. Transfer pricing guidelines also could help the tax administrators to receive a fair share of the tax base of MNEs. The OECD guidelines provide technical assistance to developing countries to help implement and administrate transfer-pricing rules in a broadly standard way, while reflecting their particular situation. The article also elaborated about the most frequently advocated alternative that was some kind of formulary sharing that would split the entire profits of the MNEs among all its subsidiaries, regards to their location and capable of winning international agreement. Clausing (1998) examined to what extent to which tax-minimizing behavior influences intra-firm trade. It has been observed there is always a strong relationship between countries' tax rates and the prices of intra-firm transactions (Clausing, 2003). It has been observed that tax saving from transfer pricing is more when foreign income, R & D activities and tax haven are combined with tax minimizing(Klassen, Lisowsky, & Mescall, 2016)

Brown (2002) discussed his opinion how transfer pricing can increase profit and decrease tax payment. Taxation planning in field of transfer pricing through formulating inter-company services and purchasing contracts, organizations are able to realize profits in low-taxation countries and shift profits around to assist in offsetting loses in others give more profit. The author also emphasis about tightening the tax loop-holes and catching many companies in breach of the law at the same time as well abolishing the dual-track corporate taxation system would bring fair share tax revenue to government. The author mentioned that through using comparable uncontrolled transaction principles such as OECD and US methodologies the inter-company transactions and transaction between "associated entities" should be priced using "arm's length principle". The author further mentioned that tangible assets must be be priced on a "transaction basis" using one three methods such as Comparable Uncontrolled Price Method (CUPM), Resale Price Method, and Cost-plus Method. The Profit–base approach also used, where the price is determined based upon performance measure of a comparable company. These include Comparable profit method, Profit split method and Global Profit Allocation. There are significant risks involved for both vendor and buyer companies that do not ensure methodology in their taxation and transfer pricing decisions, prepare Advance Pricing Agreement (APA), upgrade and tighten their internal controls and financial systems. Tax authorities do not object to transfer pricing of subsidiaries companies since their tax revenue increase because of artificial profit, where as it is objectionable by the tax administrators of the parent company (Wong, Nassiripour, Mir, & Healy, 2011).

2.7. Factors Motivating Transfer Pricing

Eden (2001) discussed the transfer pricing in international business with emphasis on factors that motivate the transfer price manipulation. Author mentioned that government regulation motivates for transfer pricing manipulations. The author presented the importance of transfer pricing for MNEs and issues that related to transfer pricing such as different s in different countries and allocation of cost. The author also stated the reason of transfer pricing became jurisdictional problems for domestic government because multinational are integrated and unitary business. The author further explained why transfer pricing was feared by government. MNEs that engaged in transfer price will affect government tax and customs duty revenue, home and host country balance of payments and the location of international production and employment. Therefore it was the potential for transfer price manipulation, which governments fear and want to prevent through regulations. Further, explained how price was negotiated between related and unrelated parties using proxy method or comparable transaction.

Gerard and Philippe (2001) investigated how a multinational firm can decide of its transfer pricing policy in presence of uncertainty regarding the acceptance of that policy by the jurisdictions involved. The multinational enterprise risk aversion such as due to a change in its ownership has been discussed by author. The authors elaborated about government policy variables, in particular the degree of "accommodation", or secondary adjustment, of the lower taxing jurisdiction which reflects the institutional arrangements set up by domestic law or tax treaties. The authors presented four possible hypothesis why there are systematic difference between exporting countries, arm's length price and corporate tax that appears to be weak. First, the nature and enforcement of IRS regulations may be so effective that companies are precluded from reducing their tax obligation through transfer pricing. Second, it may be easier to avoid taxes through other channels. Third transfer price may serve a primarily managerial role within the firm. Finally, marginal and average effective s may be sufficiently different as to prevent identification of any relation between the former and transfer pricing behavior.

McLennan (2002) discussed that Corporations implementing strategies for multinational sourcing, production and distribution are increasingly concerned with setting transfer prices that meet both business and tax objectives. The author emphasis that the management challenges within the multinational organization is twofold. i.e. to establish internal transfer pricing policies for sound resource allocation decisions, and simultaneously to provide constructive measures of performance and profit incentives to unit managers and secondly to increase vigilance and sophistication of national tax authorities, which require that overall results be demonstrably consistent with the arm's length standard. It further describes methods for determining inter-company transfer prices consistent with these objectives. He recommended that internal pricing policies be articulated in advance, to a much greater extent than is now

customary, to minimize the corporate tax burden and the risk of controversy while supporting business and tax planning strategies.

2.8. Transfer Price: Internal Benefit and Reduced External Risk

Heimert (1997) provided an introduction to the directors and senior executives of an organization with strategic guidance on transfer pricing. The author mentioned that companies start to realize that transfer pricing, when viewed from a company-wide perspective, enhances operational performance, minimizes the overall tax burden, improves cash flow, reduces legal exposures, and increases earnings. Further the author elaborated an introduction to transfer pricing and the modern strategic approach. The modern strategic approach was to view transfer pricing as a proactive means to reorganize business units and restructure transactions in a manner that enhances the performance of an organization on many different levels. In addition, transfer pricing was now multifaceted exercise that provides a company with internal benefits and reduces external risks. Furthermore, transfer-pricing analysis draws upon the talents, business experience and knowledge of many disciplines, including business operations, economics, taxation, law, accounting and finance. It was emphasized that transfer pricing problem can be solved by uncoupling transfer prices for managerial versus financial reporting purposes, making performance measurements invariant to transfer prices, and justifying certain prices to various legal authorities through advance agreement among vendors and buyers or through contemporaneous documentation .

2.9. Response to International Tax Rate

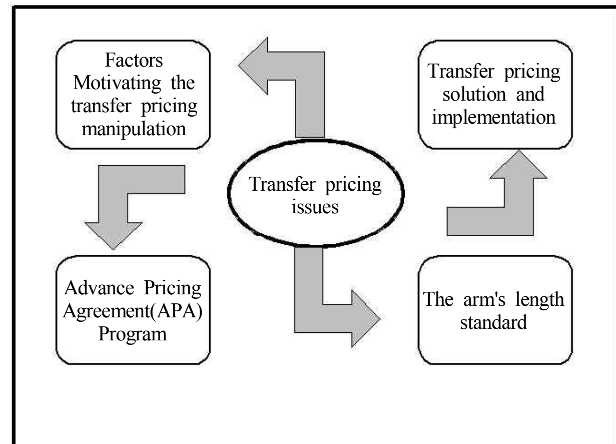
Dawson and Miller (2000) discussed on how the multinational corporation's transfer price responds to changes in international corporate effective s. Author extended the decentralized decision-making analysis of transfer pricing in the context of different s. Author also adopted and extended Bond's (1980) model of the decentralized multinational corporation that assumes centralized transfer pricing. The direction of transfer price change was as expected, while the magnitude of change was likely to be less than predicted by the Horst (1971), centralized decision-making model. The author extended the model further by assuming negotiated transfer pricing, where the analysis was partitioned into perfect and imperfect information cases. The negotiated transfer pricing result reverts to the Horst (1971), or centralized decision-making, result, under perfect information. Under imperfect information the centralized decision-making result obtains when top management successfully informs division general managers or it successfully implements a non-monetary reward scheme to encourage division general managers to cooperate. Under simplifying assumptions, centralized decision-making dominates decentralized decision-making, while negotiated transfer pricing weakly dominates centralized transfer pricing. The centralized decision making model produced boundary solution for transfer price either at the upper or lower arm's length price when the arm's length constraint is perfectly effective. Berndt and Runge (2002) discussed the mutual agreement procedures and the role of the Taxpayer. The author also mentioned the double taxation must be avoided over cross-border activities. The author further highlighted that was an obligation of taxpayers to assist the authorities. The taxpayer also could avoid conflicts between the tax authorities in different jurisdiction if they maintained the detailed documentation.

Turner et al. (1996) discussed that changes in manufacturing process, increased data communication and networking, and the increasing role of services and valuable intangible in the economy as well the creation of trading zone enable business to operate more effectively transnational. Therefore, the related party trade was growing both in volume and in scope. The authors mentioned that the implication of intra-company transfer pricing policies for government revenues can be significant as such prices can affect customs, excise and sales taxes as well as income taxes paid relevant countries. The authors also include with an overview of transfer pricing procedures and policies and the international environment governing such practices. The author presented the result of two recent surveys of taxpayers that provide an overview of the taxpayer's perspective on transfer pricing issues. Borstell et al. (1999) discussed how to design, implement and properly document a transfer pricing system for German based multinational companies. The author emphasized the importance of tightening their transfer pricing regulations and in particular increased their documentation requirements to avoid the threat of penalties on those tax payers which do not comply. The author discussed the recent development based to regulatory environment in German that prepares an update of its transfer pricing regulation. The author also presented that there has been considerable uncertainty whether the arm's length principle required that inter-company loans are secured in the same way as they would be between unrelated parties. The author mentioned that important of transfer pricing knowledge and number of transfer pricing tax audit specialist in German. Further author discussed about the application of none profit based methods and application of the resale method by German distribution companies as requested by section 3.1.3. The other issues for inbound transfer pricing also discussed by author, included cost allocation of management and administrative services, deduction of business expenses and distribution structure. Further for out transfer pricing, in the past transfer pricing by German based multinationals in many cases was based on some kind cost plus

methodology for the German production company with little regard to functional analysis and regularly no reference to potential comparables. Also for outbound business transfer pricing rarely was made an issue in the regular tax audits. Therefore author emphasized that German based multinationals increasingly seek advice how to revise and optimize their transfer pricing system, tailoring it to their business needs while at the same time optimizing business process such as supply chains under tax aspects (Perron et al., 2010). Carter (1998) discussed the complex process of transfer pricing that faced by company when it adds facilities in another state or even worse, when it goes international. The author mentioned that the key element of transfer pricing was the presence of a buyer seller relationship between units of single company. Although owner and managers may not think of one location as “selling” services or parts to another unit but the various taxing authorities or national may impose this view. Under such circumstances a company has to determine the monetary value of the goods or services and treat that amount as sales revenue of the “selling” unit and as cost of the “buying” unit. The author explained the danger a company wanted to avoid was being “whipsawed” between the taxing authorities of two jurisdictions that are having its sales revenue from a single source taxed in two jurisdictions because of overlapping or conflicting tax rules. The prospective loss of tax revenue may lead one jurisdiction to reject the new system, while a prospective increase in taxes may lead the other jurisdiction to leave the new system in place. The author emphasized that the key was not simply to set individual transfer price at the “right” level but to have a defensible system in place for setting transfer price and to make sure that the system wins government approval in all tax jurisdiction. It’s a critical issue to establish a transfer pricing for marketing and administration services. The author also discussed about the two most common approaches to setting and revising transfer price are to apply cost-plus and market procedures. Cost plus prices have the appeal of simplicity and ease of calculation and aware that cost plus transfer price can provide exactly the wrong incentive for the producing unit. The author only limited the approach to the two most common approaches such as cost plus and market based procedures. The article failed to emphasis on transfer pricing regulation, policy requirement and documentation agreement to avoid transfer pricing problems such as double taxation and scrutiny.

3. Research Methodology

The collection of information and data for this research project were gathered from various sources of secondary data. The Internet search engine such as Google, Lycos, AltaVista, find article and Yahoo provided optimum search for finding on-line articles. Sources of secondary data included journal articles published in magazines and downloaded articles from the Internet Websites. The findings of these relevant research topic article and journal were the main source of references for this research project.



<Figure 1> Research Framework

4. Discussion, Analysis and Findings

4.1. Transfer Pricing Issues

Transfer price is a mechanism adopted by both vendor and buyer companies having facilities in various countries, for distributing revenue when more than one business unit is involved in the development, manufacturing, marketing and sales of a product line. Success and value of an International company improves if transfer pricing done correctly (Dean et al., 2009). There are several predominant objectives for constructing an appropriate transfer price scheme according to some researchers(Heath & Slotta, 2009; Anthony & Govindarajan, 2007), companies own manufacturing centers, services center, other subsidiaries situated in a number of different tax jurisdiction, transfer profit through transfer pricing which effect taxation. Often companies prefer to establish the expectation that the earlier alternative involves lower transaction cost and therefore higher profits result. In order to realize the desired low transaction cost, companies set up pricing schemes between themselves and their subsidiaries. In search for more attractive profits margins, companies operating in different tax jurisdiction sometimes create transfer pricing. Transfer pricing structured in such a way to ensure that the subsidiaries in the lowest tax jurisdictions will maximize profits and thereby saving the company from quantifiable tax liability. This type of profit control or capital shifting saves company large sums of money depending on the volume of business that is done internationally. (Transfer prices may apply to departments, divisions, subsidiaries, or affiliate

business units(Cravens, 1997). Transfer price can be an effective tool for companies to achieve many different objectives, such as profit maximization, cash flow management, performance evaluation of subsidiaries and their managers, motivation and congruence(Abdallah, 2004) marketing strategy implementation, production coordination. For example, a multinational company might need to enter a new market, might keep lower import price of its foreign subsidiary. Among the various objectives, achieving maximum corporate-wide profit and divisional evaluation are often cited by managers as the most important goals of transfer pricing. Interestingly, these two objectives are often in conflict with each other. Since transfer prices provide valuation for trade between divisions inside a company, they inevitably affect the divisional profit. Transfer pricing are affected by nature of internal transfers, internal and external technological environment, and internal social environment and lot more Li and Ferreira (2008).

The Organization for Economic Co-operation and Development (OECD) has defined transfer prices to mean prices at which multinational enterprises transfer physical goods and intangible property or provide services to the associated enterprises. There has been shift in income in response to difference in corporate s for a large selection of OECD countries(Bartelsman & Beetsma, 2003). The MNEs also facing transfer pricing enquiry from local or foreign tax authorities and tax authorities mainly targeted the foreign owned MNEs. These disputes with tax authorities include administrative and management fees, royalties for intangibles, transfers of finished goods for resale, technology cost sharing arrangement and sales of raw materials. Increased surveillance most of MNEs now modify their transfer pricing policies to local government transfer pricing regulations. Due to unilateral increase in the corporate a substantial share of revenue is lost because of a decline in reported income(Bartelsman & Beetsma, 2003).

The other global issues of transfer pricing facing Multinationals include transfer pricing manipulation, documentation requirements and penalties for non-compliance. This places a substantial compliance burden on multinationals and increases the risks of penalties and costly transfer pricing enquiries. One of the risks of international business transactions is potential double taxation by multiple tax authorities. Transfer pricing is therefore a critical issue for multinationals

4.2. Factors Motivating Transfer Price Manipulation

Transfer price manipulation is the over or under invoicing of transfer price in order to avoid government regulation and policies as well to reduce tax payments. The deliberate setting of transfer prices occurs relative to some benchmark either the price must be too high or too low relative to something else. This benchmark, “too high or too low” refers to the transfer pricing that would have been set by unrelated parties that engaged in the same transaction (the arm’s length price).

4.3. Transfer pricing Solution and Implementation

As companies become larger through consolidation, and expand their operations globally, there is an increasing need to focus on transfer pricing issues and finding solution for all transfer pricing related issues. Introduction and tightening of transfer pricing frameworks deter income shifting strategies by multinational companies(Marques & Pinho, 2016). Many companies are now realizing the importance of transfer pricing issues, when viewed from a companywide perspective and adopting strategies to enhances their operational performances, minimizes the overall tax burden, improves cash flows, and reduces legal exposures as well increases earnings. It has been observed that negotiation between operations and marketing department lead to higher transfer price as compared with administered transfer price (Liu, Zhang, & Tang, 2015).

MNEs have been structuring their multinational operations and inter-company (representing vendor and buyer) pricing policies to effectively reduce their worldwide tax burden and minimize exposure. The MNEs also looked for tax services to help their companies for better factor inter-company activities into their global business strategies and minimize inter-company transaction costs. This professionals approach also would help the MNEs to deal effectively with unique tax consequences incurred whenever goods, services and intangibles cross internal and external borders. International transfer pricing is a very important issue for multinational corporations, as transfer pricing play a vital role in corporate taxation strategies(Dean et al., 2009). Therefore, many MNEs counting on tax services for their transfer pricing needs such as transfer pricing policy and practice reviews, functional analysis, economic research, modeling and analysis, economic research, planning and implementation , global documentation, controversy advisory and management services, Advance Pricing Agreements (APAs), dispute resolution and documentation software. It has been observed that tax saving from transfer pricing is more when foreign income, R&D activities and tax haven are combined with tax minimizing(Klassen, Lisowsky, & Mescall, 2016).

The MNEs could use experts all over the world to help company develop a worldwide study complying with the OECD tax provisions or the tax rules of each country involved, as well as applying the basic comparability factors and the Transfer Pricing methods according to the particular situation of their company. This will allow for significantly reducing the risk upon a potential contingency with the Tax Authorities. Tightening transfer pricing framework prevent multinational companies from shifting profit from higher to lower tax companies(Marques & Pinho, 2016)

The MNEs may annually update its international transfer pricing issues so as to reduce the risk of any possible

challenge by the Tax Authorities. It could get tax services help to fill in their Transfer Pricing returns, assist in their preparation, or review returns according to the countries legislation and to be then filed with the Tax Authorities. MNEs should have a necessary support to solve their controversies issues at any of the different stages. These supports is crucial for the defense before the inspecting authorities, both during the audit and during any assessment, request for reversal or other appeals, lawsuits at the National Tax Court and other legal stages, or in the promotion to apply an amicable settlement according to the Treaties to Avoid International Double Taxation. In mergers and acquisitions, the MNEs could analyze any possible contingency regarding Transfer Pricing, so that company may have the necessary technical tools at the right moment which may allow for identifying the risk level due to any possible adjustments to be made by the Transfer pricing practices are responsive for enhancing private gains, and thereby contributing to relative social starvation, by avoiding the payment of public taxes(Sikka & Willmott, 2010b) Authorities. It is also important for MNEs to prepare a proper procedures and documentation that will ensure the organization is in compliance with regulatory requirements of various taxing jurisdictions

4.4. The Arm's length Standard

An arm's length standard is the price two unrelated parties would have chosen if they had traded the same product under the same circumstances. The most common solution that tax authorities have adopted to reduce the probability of the transfer price manipulation is to develop a particular regulation as part of the corporate income tax code. These regulations such as U.S Internal Revenue Code section 482, the Canadian Income Tax Code section 69 and OECD transfer pricing report are generally based on the concept of the arm's length standard, which says that all MNEs intra-corporate activities should be priced as if they look place between unrelated parties acting at arms' length in competitive markets. The arm's length price is the price two unrelated parties would reach through bargaining in a competitive market. Government normally requires the MNEs to use one of several transfer price method to satisfy the arm's length standard and avoid transfer pricing manipulation. Virtually all countries have adopted the arm's length standard for determination of transfer pricing.. An "arm's length" price is a price two independent firms operating at arm's length would agree on to determine taxable profits earned in each country. If the price is not an arm's length price an alternative methods must be chosen as solution to this problem and satisfy the arm's length standard. An arm's length standard requires an arm's length pricing on transactions. This transaction must be carried out with standard method as contained in the Transfer Pricing Guidelines that issued by the OECD. Movement in exchange rates have differential effects on arm's-length and related-party prices for example an appreciation of the dollar narrows difference between the prices(Bernard, Jensen, & Schott, 2006) These methods are methods for determining an arm's length price.

a) Comparable Uncontrolled Price (CUP). This method compares the price of transferred products with the prices of similar products sold by or to uncontrolled parties. In order to use this method, products must be very similar, which is usually only true for commodities and general products.
b) Resale Price Method (PRM). This method is used in cases involving the purchase (from a related party) and resale (to an unrelated party) of property in which the reseller has not added substantial value to the goods. Thus, one of the parties is modeled as a distributor or retailer earning a gross margin or markup on each sale.
c) Cost plus Method (CPM). Under this method, an arm's length price is determined by adding an arm's length mark up to the costs of the supplier supplying goods to a related purchaser. Thus, one of the parties is modeled as a contractor earning their costs plus a percent. Under cost plus is a transfer pricing method, appropriate gross profit is added to the cost of the product in order to establish an arm's-length price but the main question with cost plus pricing is to determine what is appropriate cost and what is the appropriate plus (Arcyz and Wolosoff 2004)? Variations in practice among countries may therefore cause problems while using such method. (OECD, 2010) A follow up problem here is also how to properly split the overhead costs. (OECD, 2010, p.72-75)
d) Profit Split Method (PSM). Under this method the net income from transactions is allocated to the respective entities, based on the value of their contribution to the net profit. Thus, the profit (or loss) is split according to each party's contribution. As per profit split method of transfer pricing, 50% of the profits from the production and sale of products to be allocated to the parent corporation(Feinschreiber, 2004)
e) Transactional Margin Method (TNMM). This method makes a reference to the net profit level of similar business enterprises, which may help to provide some guidance in the determination of arm's length price to be applied on related entity transactions. Profit may be assessed in different ways in respect to total sales, operating expenses incurred or assets.
f) Unspecified Method. If none of the above methods yield a satisfactory result then one can use any other method that is economically sound.

The method used should be the one that provides the most reliable results and requires the least and most reliable

adjustments. Although there is no explicit hierarchy of acceptability, it is generally accepted that the CUP method will produce the most reliable results if the necessary comparable information is available.

The documentation must state the reasons for believing the prices are at arm's length, and must be in place when the return is filed, but does not have to be provided to the I.R.S. until requested on audit. More specifically, the documentation must provide a business description, a thorough analysis of the inter-company transactions, a detailed functional analysis of the relevant parties, a review of the transfer pricing methods resulting in the method chosen, and an economic analysis showing the arm's length nature of the transfer pricing. It is the author's experience that transfer pricing documentation not only protects the taxpayer from a penalty, but often persuades the I.R.S. that a transfer pricing adjustment is not necessary. On the whole, the arm's length principle creates a shared understanding for transfer pricing methods and reduces the risk of double taxation and other transfer pricing risk issues when MNNs conduct transaction in Multi-jurisdictions.

4.5. Advance Pricing Agreement (APA) Program

APA system is an effective problem solving tool to avoid audits, provide certainty, reduces taxpayer burden and cost –effective of transfer pricing issues. Thus, it is a tool for managing the risk of double taxation on cross-border transaction and a very effective tool when conducting transaction on bilateral or multilateral basis. Generally APA is a non-adversarial and efficient process through which a taxpayer can enhance predictability of the tax treatment of its intro-company transactions.

The APA program is a program which allows taxpayers and the IRS to reach an agreement to reach agreement on the best transfer pricing. It reaches an agreement not only with the taxpayer but also with foreign government. As a result, a tax payer with an APA has the certainty that transfer pricing often lacks. The advanced resolution of transfer pricing issues in APA program provides protection against domestic and foreign adjustment and penalties. As it was related with global dealing, the APA program will be a laboratory to identify and formulate appropriate approach to particular transfer pricing issues which can be incorporated into guidance. The APA process is designed to enable taxpayers and IRS to agree on the proper treatment of transfer pricing, including cost sharing arrangement. An APA need not to occur to all of a taxpayer's pricing arrangement and instead may be restricted to specified years, specified affiliates and specified inter-company transaction.

The APA process enhances taxpayer's compliance by providing an alternative forum to resolve transfer pricing disputes. The success of the APA program in resolving transfer pricing issues is evidenced by the increasing acceptance of APAs international community. IRS continues to identify way to improve the APA process, as evidence by the recent small business taxpayer's initiative. Because an APA is a negotiated agreement between the IRS and a private corporation that sets the formulas and methods to be used when determining the tax on the corporation's cross-border transaction. Therefore, in an effort to simply and facilitate proper tax liability reporting by companies using transfer pricing, the IRS created APAs. The same step can be applied by other countries to have same instituted Program similar to the IRS, APA system and as a result companies must sometimes negotiate to set pricing schemes with multiple countries.

5. Limitation & Conclusions

With given the short research period, one of the limitations of this project was it failed to evaluate the effectiveness of other IRS effort to resolve the transfer pricing issues. The various APA approaches in a slow economy were also not explored. The study of transfer pricing issues in current inter-company pricing trends had also suggested questions for further research. The research didn't include the data analysis of financial data of comparable companies because the financial information of company transfer price was confidential for public view. To what degree was the IRS with his program can resolve the most of transfer pricing issues and provide certainty to taxpayers? What transfer pricing training courses was available for MNEs especially for tax executives and non transfer pricing specialists and how it can bring advantages still remained unanswered.

Since transfer pricing was quickly developing into one of the most important and complex issues facing modern business today, a proper understanding of the concept was required by one and all. A proper transfer pricing policy will enhance operational performance, minimize the overall tax burden and reduce legal exposures both for vendors and buyers. It is thus, an essential part of business planning and strategy. Fortunately, several planning tools, such as documentation and A.P.A.s, can prevent unexpected surprises while avoiding adjustments and penalties.

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