ISSN No:-2456-2165

The OECD Guidelines: Provide Techniques for Determining Transfer Pricing

Jasmin
Junior Analyst, Elman Engineering, India

Abstract:- There are many advantages to globalisation, but it also poses considerable difficulties. Although multinational companies have access to resources from all of their geographic locations, such as natural resources, manufactured goods, lower-cost labour, and trained personnel, they may also bring new people into the workforce from all over the world. There are both benefits and drawbacks to business entities that operate in several countries. It may be a challenging endeavour, particularly when it comes to tax reasons.

Keywords:- *Transfer Pricing, OECD.*

I. INTRODUCTION

There are many different ways to measure the cost of products and services sold. Completing a transaction inside a company is much easier, but what about transactions with third-party suppliers? Additionally, a car manufacturer must determine the price of components, such as tyres, that are acquired from a third party, but must also determine the cost of internal engine components, such as brake pads and alternators, which may be manufactured by divisions or subsidiaries located in various regions or countries[1].

It is not only necessary for correct accounting, but it is also required for multinationals to accurately report on transactions between linked companies inside the corporation [3]. This is because the OECD has set transfer pricing rules and is working along with prominent nations to combat businesses that try to dodge taxes by sending earnings to low-tax countries. Country-by-country reports are needed for most multinational companies, since every member country of the EU, Japan, South Korea, and Australia (and most other countries across the world) is also a member of the OECD [4], [5].

Despite the long-term economic concerns, using lower-cost regions to source products is a smart way to maximise profits and efficiently use resources throughout the globe. After-tax earnings may be maximised by properly allocating the costs of cross-border shipments to each customs territory. By maintaining exchange restrictions and earnings repatriations, they may mitigate exchange risk. In the realm of operations, transfer pricing is often used to facilitate money transfers across department or division lines.

II. TO CALCULATE TRANSFER PRICING

The first problem is to design and execute an effective transfer pricing procedure. As one of the most important elements for success, establishing a reporting system that tracks business resources precisely is a must. Future planning is aided by this. When you're a company, you must choose which transfer prices will be used to establish the real transfer prices for products and services [2].

These five approaches are described in the OECD recommendations for determining transfer prices:

The most frequent approach recommended by the OECD is the Comparable Uncontrolled Price, or CUP, Method. The CUP Method compares the pricing of products or services between independent companies to the price of those same goods or services if purchased across other companies. In order to get an acceptable price from tax authorities, products and services must be evaluated under similar circumstances.

The CUP Method is also known as market-set pricing. In order to make a profit, organisations must evaluate how much money they might make selling their products to the “outside world.” Profit margins are the primary consideration; therefore, it is important for the organisation to optimise them by means of excellent practises such charging a reasonable market price for products or services provided inside the business.

This strategy has its drawbacks. For instance, if the external market doesn't meet the requirements for internal transfer price, then this method may be problematic. The comparison is not always accurate. Many commodity prices fluctuate greatly. Prices vary greatly for many commodities, and thus, it may not be a great transfer pricing model for companies that depend on commodities for production.

Another method preferred by certain manufacturers is the Cost-Plus-Percent Method, which is common in the aerospace sector. Gross profit is compared to the expenses of sales in this transaction type. The cost of the transaction is determined by the division providing products or services, after which profit is added for delivery of goods or services. In situations when other parties would be making the same amount of money, such as identical risks and market circumstances, then the markup should be equal to it.

While this approach is beneficial to the supply division in encouraging them to use efficient production methods, it may be detrimental to the company as a whole since it causes labour costs and other overhead variations to increase. Internal teams may fall into the trap of being stuck in the rut of cost-over-time without genuine competitive pricing.

In this scenario, you will be using the Resale Price Method. The Resale Price Method differs from the Cost-Plus-Percent Method because instead of counting the transfer price (which is the amount of money less any fees and taxes) as well as the markup, it simply considers the margin (minus any related expenses). This is why distributors and resellers, rather than manufacturers, are most suited for the job.

While similar external market pricing is based on net profit in transfer pricing, transaction net margin (TNMM) recently became a popular method for multinationals since the price of an international transaction is based on profit rather than comparable external market pricing. For external transactions, the methods of calculating cost used in the CUP, Cost-Plus-Percentage, and Resale Price Methods are based on the real cost of similar products or services. Rather of using the phrase TNMM, which compares the net profit margin achieved in a controlled intercompany transaction to the net profit margin gained by a comparable transaction with a third party, TNMM uses the words controlled intercompany transaction. A third party's net margin may also be used to compare the earnings from one transaction with another.

When market pricing data is unavailable, profit margin is an excellent way to compare one's cost structure to market pricing. TNMM is a fantastic tool for measuring net profit against various financial goals, like sales, expenses, or assets. The operating margin within a certain range is usually targeted. TNMM has emerged as a new taxation method, whereas the CUP Method has gained favour with tax authorities.

The Profit-Split Method (as used by TNMM) bases its calculations on profits, rather than market prices. Transfer price is established by considering how profit would have been distributed among the companies that took part in the transaction. This incorporates the respective financial contributions of the parties in the transaction as revealed by the functional profile, and is sourced from the market data that is available.

Although certain advantages and disadvantages exist to each approach, each company must assess what is most effective for its specific needs. Using various techniques for different kinds of transactions is also acceptable. To illustrate, transactions dealing with produced products may use the CUP Method, while those dealing with distributors or resellers may utilise the Resale Price Method. Organizations are not required to use various transfer pricing techniques, but they are allowed to if they want to benefit.

III. TO CALCULATE TRANSFER PRICE

By developing a technique (or a mixture of methods) for evaluating, recording, and reporting transfer pricing data, the business may formulate a plan to collect, evaluate, and report the data. To successfully implement a transfer pricing strategy, the ERP systems, the enterprise data warehouse architecture, and especially the appropriate corporate performance management platform all must be thoroughly reviewed. CPM is required to gather, process, and report on all the transaction data that exists in ERP systems. For example, the consolidation procedure should eliminate the impact of sales resulting from the consolidation process from the consolidated financial statements. A transaction's ultimate goal is to create an event that has as little effect as possible on the wider world. The transfer partner affiliates are required to include all intercompany sales and expenses of sales, which includes any commissions due [2].

To correctly implement a transfer pricing plan, consider the degree of centralization of the company. More challenging for the organisation if it is extremely independent and decentralised. A real-world example is as follows: If a company has several ERP systems, the transfer pricing policy becomes much more difficult to standardise. If the sales order and buying modules are set differently across platforms, this may be particularly difficult.

However, since many global companies undergo M&A activity, it's not surprising that the corporations are decentralised and have a high degree of unit autonomy. In order to succeed, it is important to begin by taking little steps. A corporation that takes the time to learn how complex transfer pricing is before beginning to expand their company will often discover a profitable business solution they can quickly grow. Additionally, the company should focus on what it will do when it expands, evolves, and acquires other businesses.

IV. CONCLUSION

A good way for establishing a solution that will not only satisfy regulatory requirements, but also offer significant insight and commercial advantages is to choose a transfer pricing mechanism and create a successful pilot project that can be used on a wider scale Transfer pricing may offer huge efficiency gains, but doing it properly is difficult.

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