

MULTINATIONAL TRANSFER PRICING

Canadian & British
Perspectives

ROGER Y.W. TANG

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Multinational Transfer Pricing: Canadian and British Perspectives

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Preface

The pricing of intracompany transactions is among the thorniest corporate problems for divisionalized firms. The multinational aspect of transfer pricing is even more complex because the international business environment is changing constantly. Tax and customs authorities in many countries as well as some international organizations, including the United Nations Conference on Trade and Development (UNCTAD), the European Economic Community (EEC), and the Andean Group, have intensified their surveillance and investigation of multinational transfer pricing practices.

An important objective of this book is to help readers better understand the complexity and implications of the many issues involved in transfer pricing. The book analyzes the transfer pricing practices of 272 large Canadian and British firms. The findings on Canadian and British practices are compared with those on the United States and Japan. The important similarities and differences between the four national groups are identified and explained.

In order to provide readers with some knowledge of the current Canadian and British economic environments, a brief summary of certain aspects of these two business environments is also presented. Areas examined include international trade, tariff systems, legislation on restrictive business practices and corporate income tax provisions relating to multinational firms. Readers can better interpret the transfer pricing practices of Canadian and British industries against this background.

Another goal of the book is to suggest ways to alleviate or solve some transfer pricing problems of a business organization. The principles and techniques discussed for managing a transfer pricing system should interest many executives in divisionalized firms. The general guidelines provided in Chapter 8 of the book may be especially useful to managers in those companies that are trying to establish or modify their systems.

Many corporate executives in Canada and Britain generously contributed their time and experience to this research. Sincere thanks are extended to them for their co-operation and contribution.

I also want to acknowledge the financial support provided by McGill University for this project. Many of my former superiors and colleagues at McGill provided valuable assistance in this research. Dean Picard and former Dean Shapiro of the McGill Faculty of Management deserve special recognition.

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R.Y.W.T
Calgary, Canada
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Chapter 1

Introduction

1.1 THE NATURE OF TRANSFER PRICING PROBLEMS

Transfer pricing is concerned with the pricing of goods and services transferred between divisions within a company. Instead of using the term "transfer pricing," other writers sometimes use "intracompany pricing," "intercompany pricing," "intracorporate pricing," "interdivisional pricing," or "internal pricing." A division may be a unit of the parent company or it may be a wholly or partially owned subsidiary. These interdivisional transfers may include the flow of raw materials, intermediate goods, finished goods, and a wide range of services. Determining the prices for these transfers is among the thorniest of corporate problems of divisionalized firms. Even in a purely domestic context where all the company activities are conducted in one country, transfer pricing is still vital to company profits and to the appraisal of divisional performance. Transfer pricing information may also affect many critical decisions concerning the acquisition and allocation of corporate resources, just as prices in the entire economy influence decisions regarding the allocation of national resources.

In a multinational context, transfer pricing has often been viewed as an important means of transferring the funds and earnings of a multinational company (MNC) in pursuit of its various corporate objectives.¹ Carefully designed transfer prices may yield substantial tax savings or they can be used to overcome import restrictions imposed by host countries. Because a large portion of international trade consists of transfers between related business entities,² and since the temptation for price manipulations is high, the tax and customs authorities of many governments are intensifying their surveillance of the transfer pricing practices of MNCs.³

Since the mid-1950s, the issues on transfer pricing have been discussed extensively in business literature. Most of the studies, however, deal with the theoretical merits of various pricing methods. A summary of the proposals on proper transfer prices and their proponents (or discussants) can be seen in Table 1-1. These proposals range from an extreme of doing away with transfer prices under most circumstances to the opposite extreme of accepting all methods as long as they help accomplish corporate objectives. Unfortunately, the arguments supporting