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TRANSFER PRICING: A TAX AVOIDANCE TOOL OF MULTINATIONAL CORPORATIONS

Abstract

The main thrust of this study is to examine how Multinational Corporations (MNCs) use transfer pricing practices to reduce taxable profit with a view to recommend how such practices could be minimised, to enhance the tax revenues of their host countries. This was done empirically using various studies on transfer pricing and taxation. The study concludes that various MNCs take advantage of different tax rates charged in different jurisdictions to minimise the groups' tax liabilities. This is done by using transfer pricing practices to shift profit from high-tax jurisdictions to low-tax jurisdictions. Multinational corporations as integrated entities exploit international differentials and generate integration economies by setting transfer prices that are unlikely to be the same prices arms length parties would negotiate. Tax authorities should be aware of the need to publish documentations requirements concerning transfer pricing, so as to improve on monitoring of MNCs transfer pricing compliance. Transfer pricing must be provided to tax authorities for computation of both border, and corporate income taxes. This is necessary since the activities of MNCs cut across national borders.

Keywords: Transfer Pricing, Multinational Corporation, Taxation

1.0 INTRODUCTION

Most developed countries of the world like United States of America, England etc. survive on taxation and as such they do everything possible to make sure individuals and corporations eligible pay taxes. From the description of tax, it is used in turn to finance capital expenditure which is in the good of the public. As defined by Investopedia (2011), taxation refers to the act of a taxing authority actually levying tax. Taxation as a term applies to all types of taxes, from income to gift to estate taxes. It is usually referred to as an act; any revenue collected is usually called "taxes." It is a means by which governments finance their expenditure by imposing charges on citizens and corporate entities. Governments use taxation to encourage or discourage certain economic decisions. For example, reduction in taxable personal (or household) income by the amount paid as interest on home mortgage loans results in greater construction activity, and generates more jobs.

There are various ways used by companies, especially those having subsidiaries or branches in other countries to reduce their tax bills; one of such ways is done through transfer pricing. Wikipedia (2011) refers to transfer pricing as the setting, analysis, documentation, and adjustment of charges made between related parties for goods, services, or use of property (including intangible property). It is an issue in international taxation which has continued to confuse both the taxpayer and the tax authorities. It is a valid business practice for associated companies in the pricing of inter-related sales within the group and on the other side of the divide, it creates a suspicion for the tax authorities that the pricing may be a form of profit shifting with the result of providing avenues for tax avoidance (Onyeukwu, 2010). Transfer pricing arise as a result of the existence of the interdependent activities within an organisation; the existence of these interdependencies in organisations with several divisions creates a problem of determining the price at which goods should be transferred within the organisation (Anonymous, 2011).

As far back as 1979, however, economists noted that the term “transfer pricing” often assumed pejorative connotations suggesting that large multinationals have leeway to manipulate the prices on intra firm trade and service flows for business advantage (Urquidi, 2008). When unrelated companies transact with each other, the circumstances of their commercial and financial relations are generally driven by market forces. By contrast, when related companies transact with each other, their commercial and financial relations may not be directly affected by external market forces in the same way. As a result, the prices charged for intra firm transfers of goods, for instance, between a foreign subsidiary of a multinational and its home-based parent, may differ from those charged to independent companies for the transfer of comparable goods. Plasschaert (1979) argues that the US based parent theoretically exercises control over its subsidiaries and therefore has the power to fix the level of prices applied to intra firm trade. If the overall profits of the multinational can be increased or if costs can be reduced, then the US based parent may have an incentive to artificially deviate from the “true” price for goods or services.

As a result of this practice, over 60 governments have adopted transfer pricing rules. Transfer pricing rules in most countries are based on what is referred to as the “arm’s length principle” – that is to establish transfer prices based on analysis of pricing in comparable transactions between two or more unrelated parties dealing at arm’s length. The OECD has published guidelines based on the arm's length principle, which are followed, in whole or in part, by many of its member countries in adopting rules. The United States and Canadian rules are similar in many respects to the OECD guidelines, with certain points of material difference (Wikipedia, 2011). A few countries, such as Brazil and Kazakhstan, follow rules that are materially different overall. The rules of nearly all countries permit related parties to set prices in any manner, but permit the tax authorities to adjust those prices where the prices charged are outside an arm's length range. Rules are generally provided for determining what constitutes such arm's length prices, and how any analysis should proceed. Prices actually charged are compared to prices or measures of profitability for unrelated transactions and parties. The rules generally require that market level, functions, risks, and terms of sale of unrelated party transactions or activities be reasonably comparable to such items with respect to the related party transactions or profitability being tested. This study is aimed at examining how Multinational Cooperation use transfer pricing practices to reduce taxable profit with a view to conclude on how such practices could be minimised, to enhance the tax revenue of their host countries.

2.0 LITERATURE REVIEW

2.1 Concept of Transfer Pricing

Intra firm trade involves the sale or transfer of tangible and intangible goods between related companies in two or more countries. Multinational transfer pricing is concerned with the pricing of intra firm trade. ICAN (2009) defines transfer pricing as a monetary value attached to goods and services exchanged between divisions of the same organisation. It is peculiar to all divisionalised organisation where the activities are segmented into autonomous units and great deal of authority delegated to the divisional heads. It is further defined by Adeniyi (2008) as the monetary value attached to goods and services which are being manufactured by a particular division or a decision making unit and then transferred to another division for the purpose of being utilised for the divisional final product.

Transfer price usually represents an internal pricing policy of an organisation at which goods or services are transferred from the person or department to another or from one member of a group to another (ICAN, 2009). Going by the above it can be deduced that transfer pricing is mostly used by organisations that have divisionalised units and this divisions have one connection (or dependent) with each other such that goods or services produced by one department or unit will be required by another unit or department for further production or sales.

Conditions that will facilitate the application of transfer pricing policy as pointed by Adeniyi (2008) include that an organisation must adopt a divisionalised structure rather than a centralised or decentralised structure; each division must be vested with absolute authority on all the areas of decision making (i.e. autonomous in nature); the division must also be identified as either a profit centre or an investment centre but not as a cost centre. Also one of the divisions must be manufacturing a component or sub-assembly which other division will require for the purpose of its final product and divisional managers involved must be eager to transact business with each other.

According to Ernst and Young (1997, 1999), transfer pricing which is the pricing of cross-border intra-firm transactions between related parties used to be a term known only to a few international tax specialist, but however, the trend has changed as it now the top international taxation issue faced by multinational corporations across the world. The reason for this change is not farfetched; since every cross border transaction means that two governments are involved in regulating the transfer price, there is always the possibility for conflict. As noted by Rugman and Eden (1985), the multinational corporations see differences in corporate income taxation system as exogenous market imperfections that can be arbitraged through tax avoidance strategies, such as tax deferral, financial manoeuvres (e.g. double dipping), and transfer pricing manipulation (over- or under invoicing intra-firm transfers of goods, services or intangibles). Also concern about inappropriate (too much or too little, but particularly too little) tax paid by multinational corporations has led national tax authorities to devise even more sophisticated national tax systems to regulate transfer pricing. Furthermore, disputes between home and host government over multinational corporations' tax has led national tax authorities to reach out to the international level to devise a series of bilateral and international institutional responses (Eden, 2001).

2.2 Qualities of Transfer Pricing

The following are the qualities of a good transfer pricing policy as postulated by ICAN (2009) and Adeniyi (2008);

a. **Goal Congruency:** There is a need to select the transfer pricing method that will ensure that any optimal decision taken by the division will also be optimal from the corporate perspective. In other words, any method chosen must reduce sub-optimality to the barest minimum. This is also known as the concept of uniformity of objective. The condition implies that a good transfer pricing policy must be used to sacrifice the long term corporate objectives of the entire organisation for personal or divisional objective.
b. **Performance Evaluation:** An ideal transfer pricing must be capable of being relied upon as a premise for evaluating divisional performance in terms of efficiency level and effectiveness. There is a need to select the transfer pricing method that management would be in a position to adopt in

evaluating the performance of each divisional manager as effectively as possible. Sequel to this, the contribution made towards the corporate profit by each division should be distorted by the transfer pricing method chosen.

c. **Autonomy:** There is a need to select the method that will preserve the independence of each division so that the failure of one division will not affect the success of another division. The transfer price must be set such that it guarantees the independent nature of all the divisions involved.

d. **Motivation:** The agreed transfer price musts be capable of motivating both the buyer and the seller or the transferor and the transferee. This objective or quality of transfer pricing has to do with an in-house issue. The price that is fixed is to be accepted by the parties involved; this is as a result of what the organisation seeks to achieve by fixing such transfer price.

2.3 Types of Transfer Pricing Methods

It will be relevant to conceive at the onset that it may not be possible for a particular method of transfer price to simultaneously achieve all the listed qualities or objectives above. As a result of this fact, the quality of performance evaluation will contradict goal congruence and it is also doubtful if a particular method of transfer can simultaneously motivate both the buyer and the seller. The following are the different types of transfer pricing method in use by organisation:

Cost Based Transfer Method: Under this approach, the relevant transfer price to charge between the transferring division and the receiving division will depend on the actual cost of production to the manufacturing division (Adeniyi, 2008). The selling division sells the goods to the buying division at the cost of production incurred by the selling division. It should be noted that cost is viewed in different ways and as such ICAN (2009) and Adeniyi (2008) posit that cost based transfer pricing method is further categorised into relevant cost, total cost, mark-up and standard cost transfer prices. Cost based transfer pricing have advantages of it being useful in decision making analysis, especially where the organisation is using the marginal costing approach; also, it assists in measuring production efficiency by comparing actual cost with budget. Cost based transfer pricing has no unrealised profit involved in its stock computation and it offers the only available opportunity for products that have no market. The major disadvantage of this method is that, managers who are supposed to be autonomous are not allowed to use their initiative in the pricing decision, which may result to encouraging sub-optimality among the divisional managers. The approach cannot be used to evaluate divisional performance especially those identified as a profit or an investment centre.

Market Based Transfer Price: Under this approach, the relevant transfer price to charge between the selling and buying divisional managers will represent the prevailing market price within the market as at the date of the transaction. This implies that both the selling and buying divisional managers are expected to operate at arm’s length. A major plus for using this approach is that it guarantees divisional autonomy and allows for divisional managers to use their initiative in the pricing decision, which in the long run allows for performance evaluation among the managers. Its shortcoming is that, because of its market nature, it is prone to market fluctuations and will complicate the process of stock valuation as a result of the need to eliminate the unrealised profit on stock.

Negotiated Transfer Pricing: Under this method the selling division and the buying division agree in advance to use a mutually acceptable transfer price. The relevant transfer price to charge between the selling and buying divisional managers will represent the outcome of negotiation between the two divisional managers. The central management will encourage the two divisional managers to agree on the appropriate transfer price because many factors have been have been effectively considered to reduce disputes on the transfer price fixed. With the use of this method, the motivational impact among managers will be stronger and the method is not prone to market fluctuations. The method is not encouraging as negotiation may be time consuming. The price to be fixed may be influenced by the negotiating ability, personality and fluency of the mangers involved which may result to the corporate interest being subordinated to individual divisional interest and goal dissimilarity. It is not a good method of evaluating performance as it can be used to conceal inefficiency on the part of the managers involved.

Arbitrary Transfer Pricing: Under this method the transfer price is determined centrally based on what top management conceived to be the most beneficial to the company as a whole. Individual divisional managers may have some say but no control over the price set. In other words, the relevant transfer price to charge between the selling and buying divisional managers will be determined by the central management with or without the consent of divisional mangers. The time spent in negotiation is saved, and uniformity and stability tend to prevail. The approach is considered ideal for planning purpose because of its specific nature and will guarantee the concept of goal congruency. It does not grant the divisional managers autonomy and the profit and cost consciousness may suffer if the fixed price is not considered realistic.

2.4 International Transfer Pricing

Transfers within an international group will often be cross-border, between divisions in different countries. With the advent of multinational corporations and their growth, they have added more complicated dimension to transfer pricing. In setting an international transfer price, a multinational company will usually concentrate on satisfying a single objective which is sole on the minimisation of taxation (ICAN, 2009). The other broad objectives of transfer pricing are considered secondary. By minimising income taxes through transfer pricing, the company’s profit after tax will increase. However, national tax authorities (i.e. the home and host country of the multinational corporations) are now taking a very close look at whether the international transfer price constitutes an "arm length price". Arms length price is the price two parties would have agreed to transact business if they had not been related (Wikipedia, 2011).

Benke and Edwards (1980) recognised some other issues that merit consideration in the setting of transfer pricing by the multinational corporations. These considerations include import duty minimisation, adjusting for currency fluctuations, avoiding economic restrictions and presenting a favourable financial picture for a foreign affiliate in order to enhance borrowing opportunity or provide a temporary competitive edge. Similarly, Lucey (2003) stressed that the level of the transfer price can also affect the amount of import duties to be paid and is a way of repatriating dividends. In fact some countries place restrictions on the amount of dividend that can be paid from the branches of multinational corporations in their country. Where these restrictions exist, it may be partially avoided by charging a high transfer price in the particular country. In his opinion, Adeniyi (2008) posit that multinational corporation can take advantage of different tax rates charged in different jurisdictions to minimise the group's total tax liability. Ways of doing this include the use of transfer pricing to reduce the profitability of subsidiaries in high-tax countries and increase the profitability of its subsidiaries in low-tax countries. He also noted that changes in the transfer price can redistribute the pre-tax profit between subsidiaries, but the total pre-tax profit will be the same. However, if more pre-tax profit is earned in low-tax countries and less profit is earned in high-tax countries, the total tax bill will be reduced.

2.5 Response of Global Tax Authorities to Transfer Pricing

Governments are aware of the effect of transfer pricing on profits and in many countries, multinational corporations are required to justify the transfer prices that they charge. Multinational corporations could be required to apply the arm's length price to transfer prices; in other words, they might be required under the law to use market-based transfer prices (i.e. the prevailing market price) so as to remove opportunities for tax avoidance (Adeniyi, 2008).

To increase domestic tax revenues and prevent perceived abuses of the tax system, global taxing authorities implemented stringent documentation requirements that multinational corporations must meet in order to detail the prices that they are charging for intra-firm transfers. In 2007, the Norwegian Ministry of Finance published draft documentation requirements concerning transfer pricing, with a view towards improving the ability of the Norwegian tax authorities to assess companies' transfer pricing compliance (KPMG, 2007). Also, Ceteris pointed out that in India, the result of a 2007 tax court ruling highlighted the latitude being provided to local tax examiners in bringing transfer pricing issues to court, and also placed the onus on taxpayers to perform thorough benchmarking analyses.

With an interest in harmonizing the activities of its member countries the Organisation for Economic Co-operation and Development (OECD) released guidelines on transfer pricing in 1995 (OECD, 1995). In accord with the OECD's mission to support economic growth and financial stability, the OECD guidelines were developed to provide a common framework for governing intra-firm transfer pricing. Although often vague and lacking a means of penalty enforcement, they are the closest thing currently available to a unified, multinational, playbook for establishing appropriate transfer prices. For developing countries and taxing authorities just turning their attention to transfer pricing, the OECD guidelines often form the basis for their own directives. In July 2007, for example, KPMG noted that Spain proposed transfer pricing regulations that are based on the OECD Guidelines (KPMG, 2007). Through its Centre for Tax Policy and Administration, the OECD organizes regular conferences with industry representatives and tax authorities from member countries.

Not to be outdone, the European Union seeks to streamline the documentation requirements of its member states through an EU-wide approach to transfer pricing known as the "master file." This would contain common background information relevant for multinational enterprises operating in EU countries, which would then be supplemented by "country-specific documentation" (PriceWaterhouseCoopers, 2006).

2.6 Problem with taxing multinational corporation

In any international tax situation there are in effect, three parties – the multinational corporation and the two tax authorities (i.e. the home and host country). When one government taxes an multinational corporation unit (parent subsidiary or branch), it has implications for the tax base of the other country, since, in an intra-firm transaction, a higher tax in one country leads to a lower tax base in the other country (Stopford 1994). Multinational corporation create particular problems for tax authorities that do not occur when taxing domestic firms. The multinational corporation is an intergrated business group consisting of several related affliates located in different countries, under common control, with common goals and sharing a common pool of resoruces (Eden, 2001). Governments are defined and limited by their borders; multinational corporation have a global reach and as such their activities cross national borders and create interjurisdisctional issues for national tax authorities.

From the multinational corporation perspective, as the number of jurisdiction rises, the costs and risk of mutiple levels of authority increase. The enterprise is faced with higher cross-border transactions costs, greater interaction cost with a wider variety and number of government and increased levels of political risks (Sunderam and Black 1992, Kostova and Zaheer, 1999). Vernon (1998) also notes that where taxes are involved, multinational corporation have always been obliged to navigate through a sea of conflicting national claims. With every national tax code differing from the other, the multinational corporation have constantly been exposed to the risk that the same dollar of their global profit might be taxed by more than one tax authority (Vernon, 1998).

From the government's perspective, the global reach of the multinational corporation raises three types of taxation problems – jurisdiction, allocation and valuation. In terms of jurisdiction, the problem is the detemination of government that has the right to assess the multinational corporation's income to tax and if the two governments claim the same right to tax, the problem of which government claims the priority over the others arise. Also, if the tax base arise in more than one country, another challenge of which government has the right to tax this income base arise. These are some of the problems that arise as a result of the income arising from more than one jurisdiction. Also, the global reach of multinational corporation raises additional jurisdicitional issues since it gives multinational corporation the ability to avoid the national reach of government regulations, engaging in practices that reduces their overall tax payments. Low tax jurisdictions, such as tax havens, provide inviting location for multinational corporation, but at the same time create tax competition between nation-states (Eden, 2001). It is imperative for governments to prevent multinational corporation from using these multiple jurisdictions to hide profit and reduce taxes on worldwide basis and also to curtail destructive international tax competition among national tax authorities.

The second issue of allocational arises as a result of the multinational corporation sharing common overheads and resourcses. From the multinational corporations perpective, these resources should be allocated where they provide the greatest overall advantage to the multinational corporation group. National trade and tax barriers distort this allocation and raise transaction and governance cost for the multinational corporation. From the government's perspective on the other hand, allocation of cost and income from these common resources shared by groups of multinational corporation among jurisdictions becomes a major challenge. As opined by Eden (2001), common resources are a source of competitive advantage for the members of the multinational corporation family, but they are also a source of interdepencies that make it difficult to disentangle the multinational corporation's global income for tax purpoess. Setting transfer prices for intra-group transactions is therefore an activity prone to international disputes.

The third issue is valuation. According to Eden (2001), the Multinational corporation's income and expenses must not only be allocated to one or more members of the multinational corporation group, but they must also be valued. This directly leads to the issue of transfer pricing; the valuation of intra-firm transfers. Because the Multinational corporation is an integrated entity, with the abiity to exploit international differentials and generate integration economies not available to domestic firms, transfer prices are unlikely to be the same prices arm's length parties would negotiate. The prices of traded tangibles, intangibles and services within the various units of the enterprice are basically accounting or book-keeping prices set for internal reasons. However, since multinational corporation activities cut national borders, transfer prices must be provided to tax authorities and used to calculate both border taxes (tariffs, export taxes) and corporate income taxes. Therefore, internal and external factors will influence the multinational corporation's choice of transfer prices. The fear of tax authorities is that external factors will dominate and the multinational corporation will set its transfer prices so as to avoid or evade taxes.

The basic problem for national tax authorities is that the multinational corporation is an integrated, complex network of related firms that spans accorss multiple tax jurisdictions but has externally fuzzy organsiational boundaries, much like a multi-headed ever-moving hydra. The integrated nature of the multinational corporation makes it difficult to regulate them at the domestic level alone (Eden, 2001). The above mentioned characteristics of the multinational corporation complicate international allocation and valuation of the multinational corporation revenues and expenses, and thus the taxation of its global profits, creating interjurisdictional conflicts not only between multinational corporation and nation-states but also between home and host government.

2.9 An Alternative Approach to Taxing Multinational Corporations

The arm's length standard is based on the separate accounting or separate entity approach. The borders of a firm are defined according to national boundaries; this is known as the water's edge. Domestic affiliates and foreign branches are consolidated with the parent firm for tax purposes, but foreign subsidiaries and other affiliates of the multinational corporation are treated as separate firms. Income of the multinational is measured using separate accounting for the domestic and international units of the multinational corporation. Since the parent's tax returns is consolidated with the domestic affiliates and foreign branches, transfer prices required for tax purposes. However, intra-firm transactions between the parent and its foreign affiliates must be measured and accounted for.

The arm's length standard is not the only norm that could be used to guide the international tax transfer pricing regime, nor is the standard without its critics. A basic criticism is that a separate accounting approach to tax multinational corporations is inappropriate because it is difficult to separate out the contribution each affiliate makes within an integrated multinational corporation group. More specifically, the transaction methods are difficult to apply in practice and the profit-based methods are easily abused. Vernon (1998) notes that the underlying problem is that national tax authorities are trying to place an exact figure on a concept that does not exist, e.g. true profit that arises in national taxing jurisdiction. In the real world, the profit allocated to each country by a multinational corporation commonly is an artefact whose size is determined largely by precedent and by the debating skills of lawyers and accountants.

The alternative would be to tax multinationals on a global consolidated basis using a global formulary method (unitary taxation) for taxing multinational corporation profits. Under this approach, each affiliate's share of certain factors (e.g. sales, employment, assets etc), as a percentage of the worldwide multinational corporation amount of these factors (however weighted), would be multiplied by the multinational corporation's total global income to compute the tax to be paid in that jurisdiction. A global formulary approach will usually require three steps – deterring the boundaries of the multinational corporation for tax purposes, accurate estimating the multinational corporation's global profits and establishing the formula for allocating the global profits among the various national tax jurisdiction (OECD, 1995). The unitary taxation has been little used in practice. However, the United States and Canadian provinces use this approach to allocate sub federal corporate tax revenues among themselves.

2.10 Transfer Pricing in the Nigerian Context

In the Nigerian context, the issue is not helped further as there is an absence of clear transfer pricing regulations (Onyeukwu, 2010). An increasingly share of world trade consists of cross-border transactions within groups of affiliated companies, more so the advent of considerable foreign direct investments in Nigeria. These has literally collapse the national boundaries between countries and this situation has created difficult transfer pricing questions in cases where there are inter-related transactions (Augustine, 2011). The key important factor of transfer pricing is based on the arm's length rule. This being that pricing terms between related party in the exchange of goods and services should achieve same results as if parties are unrelated. The essence of this requirement is that the quantum of profit which ordinarily should be subjected to domestic tax does not become a gain to another country to which profit is shifted.

According to Onyeukwu (2010), under the Nigerian tax laws, the basis for charge to tax of transactions between related companies is provided in section 13 (2) (d) Companies Income Tax Act (CITA) where the Act empowers the Federal Inland Revenue Service (FIRS) make adjustments in order to reflect arm's length transaction in situations where in its opinion it deems the trade or business or activities between related parties to be artificial or fictitious. The power of this provision is that the FIRS shall disregard any disposition, which in this effect means any trust, grant, covenant, agreement or arrangement that would reduce the tax payable and direct any such adjustments in order to counteract the reduction of liability to tax. By implication, the tax authority is conferred with the responsibility to make adjustments where the internal pricing mechanisms of the related parties tend not to reflect the open market prices. The implication of the sections of CITA seem to place issues of determining transfer pricing within the Nigerian context as an exercise of subjective judgement by the tax authority. The duty of FIRS making adjustments to provide for arm's length treatment of intercompany transactions is based on where it is of the opinion that there are threats of tax avoidance by virtue of the transaction. The above provisions simply portray the determination of transfer pricing in the Nigerian context as an exercise of subjective judgement and personal opinions of tax authorities. The apparent paucity of regulations to guide the tax authority in appropriately determining transfer pricing issues has created a need for Nigeria's legislations to be updated to incorporate such emerging trends (Augustine, 2011).

According to Onyeukwu (2010), in Nigeria, there are no hard and fast rule that are clearly indicative of whether specific intercompany transactions relating to their pricing terms are carried out in variance to the open market price of the goods and services. Every multinational business entity is set up with the primary objective of making profits and several considerations underlying their profit motive come to bear in determining the pricing of their goods between associated parties. Therefore, it is important for the FIRS to determine in its opinion the factors that would trigger recognition of an intercompany transaction as being at variance with arm's length principles. Some of the factors include the presence of intercompany intangible transactions, which occurs where there are large royalty payments by a loss-making affiliate. In this instance, it raises the concern of whether the Nigerian resident company is actually benefiting from the licensed intangible and the likelihood that the large royalty payments is a ploy for taking out profits attributable to the local affiliate outside of the tax net. Another factor is where there are transactions with companies situated in tax havens. Where intercompany transactions revolve around a controlling entity situated in any of the perceived tax havens, any such payments made for the benefit of the offshore entity would raise the presumption that the payments is to shift income to the tax havens. The company is ordinarily deemed to lack substance and such would not have justification to have earned the income if transacting at arm's length. Where there is a subsidiary to a foreign parent i.e. where there is a controlling interest by the parent company in the business of the subsidiary, the tax authority reserves the 'opinion' to deem it artificial and fictitious whereby it can make transfer pricing adjustment for the appropriate tax payable.

CONCLUSION

From the foregoing, transfer pricing is arguably a tool or an instrument that is employed by Multinational companies to reduce their overall tax liabilities, which resultantly reduces the tax revenues accruing to government of countries where such MNCs carry out their business operations. It has become increasingly difficult for national tax authorities to assess the income of multinational corporations to tax as a result of tax base of the former arising in more than one jurisdiction.

Multinational corporations take advantage of different tax rates charged in different jurisdiction to minimise the groups' total tax liabilities. This is done through the use of transfer pricing to reduce the profitability of subsidiaries in high-tax countries and increase the profitability in low-tax countries. The global reach of multinational corporations races additional jurisdictional issues, as it gives multinational corporations the ability to avoid the national reach of government regulations, engage in practices that reduces their overall tax payments. Multinational corporations as integrated entities, with ability to exploit international differentials and generate integration economies not available to domestic firms by setting transfer prices that are unlikely to be the same prices arm's length parties would negotiate.

RECOMMENDATIONS

Tax authorities should be aware of the need to publish documentation requirements concerning transfer pricing, with a view towards improving the ability of tax authorities to assess MNCs transfer pricing compliance. Bringing of transfer pricing issues to court and also place the onus on tax payers to perform thorough benchmarking analyses.

It is imperative for governments to prevent multinational corporations from using multiple jurisdiction to hide profit and reduce tax liabilities on worldwide bases also to curtail destructive international tax competition among national tax authorities. Finally, since multinational corporations activities cut across national borders, transfer pricing must be provided to tax authorities for computation of both border taxes (such as tariff and export taxes) and corporate income taxes.

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