Transfer prices – a debate amongst multinational companies and tax authorities

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Abstract. *Transfer pricing is a topical subject because it has a strong impact on affiliated companies as well as on the countries in which these companies operate. Transfer pricing is one of the most important aspects of international tax, but a practical approach will help to focus on solutions to these problems, solutions that will help countries emerging to address evaluation issues transfer pricing in which is robust and equitable to all parties involved.*

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1. Introduction

The range of transfer pricing is extremely complex and these have occurred in the context of a group of companies carrying out economic activities in several states. The evolution of transfer pricing is closely related to the development of trade relations between states and the emergence of the first multinational groups with operations in these states.

Transactions between affiliated companies need to respect the market price so that the value of the business is not affected, but if these transactions are not within the "market range", the activities are considered not to be transparent because the profits earned are not properly reflected. Transfer pricing is an international tax problem and in order for businesses to operate in optimal conditions, the OECD (Organization for Economic Cooperation and Development) directives have established the arm's length principle and have established it as the basic principle of price theory of transfer. They are seen as a legitimate business opportunity for transnational corporations, and are often used to financially distort the outcome of the transaction and evade taxing. The transfer price is ultimately used to determine whether the taxable income at cross-border level is considered to be the arm's length and whether it falls within the calculated range. Lately, tax administrations have been exposed to need to prepare complex documentation on the use of transfer pricing in transactions conducted by multinational companies with entities in the same group.

In recent years, transfer prices have been a sensitive subject of national and international interest. Transnational companies see transfer pricing as tax optimization and the state wants to adopt measures to protect tax revenues and especially to avoid outsourcing the taxable base of taxpayers to affiliated entities in order to obtain a more favorable tax regime. Most of the time, affiliated companies transactions are at the border, between licit and illicit, thus seeking to take advantage of certain regulatory dysfunctions of the tax systems in the states in which they operate.

Since transfer pricing have important implications for the budgets of Member States, there is a complexity increasingly higher tax issues for both tax administrations and companies are required to comply with different tax rules in the countries where they work.

These national tax rules generate conflicts of interest between tax administrations and commercial companies, and the lack of administrative coordination between tax jurisdictions can cause the decline in capital in some countries and the loss of tax revenue.

2. Compliance practices in the field of transfer pricing

In each OECD member country, according to its own national legislation and administrative procedures, certain tax compliance practices are developed and implemented. Most national compliance practices have three main characteristics:

- diminish the possibilities of non-compliance (eg by withholding taxes and communication of information);
- provide positive assistance for compliance (eg through educational elements and published guidelines);
- adopt an attitude of deterrence of noncompliance.

To adapt to the particularities of different tax systems, but also due to the aspects of national autonomy, tax compliance practices remain the resort of each country. Thus, the arm's length principle is the International Standard to which OECD member countries have agreed to be used to determine transfer prices for tax purposes (Article 9 of the OECD Model Tax Convention). However, the correct application of the principle of full competition or the principle of market value presupposes the existence of clear procedural rules that will provide the taxpayer with adequate protection and provide the guarantee that tax revenue is not transferred to countries with very difficult procedural rules. Transfer pricing legislation follows generally the guidelines of the Organization for Economic Cooperation and Development (OECD) and requires that transactions between related parties be made at market value. If transfer prices are not set at the arm's length, the tax authorities have the right to adjust taxpayers' revenues and expenses to reflect market value. Applying the arm’s length principle can be an intensive process of resources. Compliance with it may impose a large administrative burden on taxpayers and tax administrations, which can be exacerbated by both the complex rules and the resulting compliance requirements. These facts can determine whether and when there will be adequate safety rules in the field of transfer pricing. Therefore, the benefits of accepting this principle are the high level of certainty about its acceptance, the balanced relationship both in the relationship between two tax authorities located on antagonistic positions and in the relationship between taxpayers and tax administrations, as well as the practical applicability his.

It is accepted that transfer pricing is not an exact science and that the application of those transfer pricing techniques involves the application of information, validated and judged by taxpayers, but also by tax authorities. In view of the "gaps" of qualification, information and limited resources in many developing countries, this issue of transfer pricing may be very difficult. Therefore, it is necessary to have the best officers, which could lead to the development of the competencies of the organization, given their special abilities. International tax issues have been a top priority in the political agenda in recent years. Integration of national economies and markets has substantially increased threats to countries' tax systems. Several governments have agreed on a comprehensive package of measures that require coordinated implementation through internal legislation and international treaties, and these will be enhanced by selective monitoring and increased transparency. Many traditional strategies that allow double non-taxation will be restricted if it will adopt a broad adoption of such measures, especially aligning national standards to best practices. To initiate a tax audit, the tax authorities plan and implement reviews thereof taking into account the types of transactions involved companies, including transactions between companies, income levels, performance indicators, restructuring, recurrent losses, types and amounts of active. However, when a member of a multinational taxpayer is screened, it is possible that national tax compliance rules in the country where it is verified to have consequences in other tax jurisdictions. In such situations, transfer pricing is involved because the transfer price has implications for taxes registered in the tax jurisdiction of the associated company involved in the controlled transaction.

There is also the situation where the transfer price of a transaction is not accepted in other tax jurisdictions and the group of multinational companies may be subject to double taxation. Therefore, tax authorities should take into account the market value principle when applying national compliance practices. At the same time, they must also take into account the implications of those tax compliance rules for transfer pricing in other tax jurisdictions and try to prevent double taxation of taxpayers.

According to the OECD Guidelines, paragraphs 4.4-4.5, at the level of the OECD member countries, although there are other tax compliance practices, the most effective **are the three**, which have a major impact on the tax authorities in the amicable procedure and allow for compliance with their own rules on transfer pricing: **verification practices, probationary obligation and sanction systems.**

In OECD countries, **verification practices** vary depending on a number of factors, such as: the system and structure of tax administration, geographic size and demography, domestic and international trade levels, educational levels and historical influences.

Transfer pricing cases represent both tax authorities and taxpayers real challenges in verifying practices. Since the transfer pricing field is not an exact science, it is not easy to set the only correct price for full competition and it will have to be estimated within an acceptable range of values. No use of pricing methodologies, will not give a clear result, as taxpayers may encounter some difficulties when the tax authorities propose the use of a particular method, which often is not the same as that used by the taxpayer. Because of the complexity of this area is very likely to occur and mistakes from taxpayers, no matter how well intentioned they are. Tax authorities must first of all be flexible in their approach and not claim unrealistic precision, and secondly, they must take into account the taxpayer's commercial thinking about the application of the full competing principle, so that price analysis can be anchored in business realities (OECD Guidelines, Chapter 1, paragraphs 1.68-1.70). In Romania, the Fiscal Procedure Code for 2016 establishes, inter alia, that "all affiliated companies will be required to prepare a transfer pricing file, and not only those expressly requested to do so in as part of a tax inspection, as is currently the case"(Fiscal Procedure Code, Article 108, paragraph (2) - Drawing up the transfer file, published in the Official Gazette of Romania, No. 547 of 23 July 2015).

In order to document compliance with the full competing principle, the taxpayer / payer carrying out transactions with affiliated persons is required to prepare the transfer pricing file. In Romania, at the request of the competent central fiscal body, the taxpayer / payer is required to submit the transfer pricing file. "The amount of the transactions for which the taxpayer / payer has the obligation to prepare the transfer price file, the deadlines for its preparation, the content of the transfer price file, as well as the conditions under which it is requested, shall be approved by ANAF President Order" (Order of the ANAF President no. 222/2008 No. 129 of 19 February 2008).

In addition to verification practices, certain tax cases must also be supported by evidence. Most of the time, in most OECD member states, tax authorities bear the **probative obligation** in their internal tax relationships (eg establishing taxes and complaints) and litigation. But there are also states where the evidentiary burden lies with the taxpayer. In the case of transfer pricing, the rules on probation obligation in OECD member countries can pose serious problems, because if this rule guides the behavior of taxpayers and tax authorities, significant conflicts and even double taxation can occur. Therefore, neither tax authorities nor taxpayers should abuse this rule in transfer pricing analysis, but both camps should be prepared to establish transfer pricing in good faith and ensure that they are in line with the principle of full competition, irrespective of who has the burden of proof.

Sanction systems are aimed at removing non-compliance regarding certain procedural requirements in the field of transfer pricing, such as timely provision of necessary information or submission of declarations, or correct setting of tax obligations. It should be noted that the range of compliance measures differs from one state to another, as well as the types of sanctions, because they depend on the fiscal system of each country and are made on the basis of national needs and national balance. In practice, sanctions may imply (OECD Guidelines, Chapter IV, Paragraphs 4.20-4.21):

- civil sanctions: presuppose procedural compliance, such as timely and complete filing of tax returns and reporting of information. These sacrifices usually involve small and fixed amounts and are granted for each day of non-payment, but there may also be some significant penalties for declaring a lower amount of tax liability;
- penalties: applies in cases of significant fraud and often imposes a large probationary obligation on the part that imposes the sanction.

For most OECD countries, improving compliance with transfer pricing is a real concern, so proper use of the sanction system is appropriate in addressing this issue. Since transfer pricing occurs in cross-border transactions, these involve tax bases in two jurisdictions and a tighter penalty system in one jurisdiction may influence the taxpayer to declare another tax revenue, which leads to non-compliance with the full competing principle.

3. Using safe harbors in the field of transfer pricing

It is known that the application of the market value principle is a complex process, involving a fair trial, as it may present uncertainties and impose certain administrative burdens on taxpayers and tax authorities. Difficulties in applying this principle can be diminished by ensuring that taxpayers should comply with certain simple rules for users of transfer pricing. These provisions are called "safe harbor" or "safe paradise". In the context of taxpayers, secure ports are a statutory provision that involves exempting certain taxpayers from certain tax obligations by replacing them with more simple or exceptional ones. In the field of transfer pricing, these ports may, for example, require taxpayers to fix transfer prices in a certain way by using a certain simplified transfer pricing method, or to comply with certain information reporting and record keeping conditions, on controlled transactions (OECD Guidelines, Chapter IV, Section 4.94).

The main objectives of secure ports are the following: diminishing compliance for eligible taxpayers in determining the conditions for full competition for controlled transactions; guaranteeing certain taxpayers that the price used for certain controlled transactions will be accepted by tax administrations without further revisions; exempting authorities from further scrutinies or checks on taxpayers on transfer pricing.

In practice, there are three categories of factors that support the use of secure harbors:

I. diminishing compliance - this factor refers to applying the principle of market competition, which may require the collection and analysis of information that can be difficult to obtain and verified. This is because complexity can be disproportionate compared to the size of the multinational or transaction level. Using ports could help comply by exempting taxpayers from certain provisions because they are designed to provide some flexibility in areas where there are no comparable prices (for example, using profitability as a simplified method would help the taxpayer save time and resources for pricing);

II. certainty or safety - this factor refers to the certainty offered by the safe harbor in terms of accepting transfer prices by tax authorities. Taxpayers will therefore be certain that they will not be subjected to additional controls or to recalculation of the prices obtained (for example, a set of industry-appropriate business additions or certain profit indicators);

III. administrative simplicity - this factor implies administrative simplification, since once the transparency of taxpayers for the safe harbor is established, they will be subject to minimum examinations on transfer prices or the results of controlled transactions and tax authorities will allocate the remaining time and resources to check other operations.

The use of safe ports in the field of transfer pricing can also create some adverse consequences for certain taxpayers and tax authorities should carefully analyze these situations in relation to anticipated benefits. These problems arise as a result of the implementation of these safe harbors in a particular country and will thus affect not only the calculation of taxes in that country, but will also interfere illegally in the calculation of taxes of associated companies in other jurisdictions, or may produce prices or results which may be inconsistent with the principle of full competition.

A first problem that may arise from the use of safe ports refers to the **risk of double taxation and the difficulties of the mutual agreement procedure.** However, the possibility of double taxation would remove the objectives of certainty and simplicity pursued by the taxpayer when making the decision to choose a safe harbor. Thus, all taxpayers who use safe ports must be prepared to accept any double taxation arising from foreign tax authorities invalidation of the transfer prices reported. Obtaining a tax exemption from double taxation by taxpayers using the safe harbor in a foreign country will only be possible when they demonstrate that the results obtained under the safe harbor rules are consistent with the principle of full competition. Similarly, transfer prices can generate revenue / expenditure adjustments, which can lead to double economic taxation. It should be specified that the mutual agreement is not used to negatively adjust the transfer prices established in the safe harbor system and may have an effect in favor of the authorities in foreign jurisdictions. The safe harbor regime for two jurisdictions may differ, and each jurisdiction is struggling to protect its income, so in practice, it is unlikely that two countries will be able to harmonize their conflicting ports in order to avoid double implosion.

Safe ports can influence the behavior of taxpayers and can lead to **tax optimization**. Companies may change their transfer prices to transfer revenues to other countries with mild tax regimes. This phenomenon could also trigger the emergence of tax evasion if artificial arrangements are made to exploit safe harbor provisions. Tax evasion auctioning in the context of transfer prices is also influenced by the government's granting of tax incentives, scales, deferrals or tax exemptions, thus benefiting taxpayers who have failed to honor their tax obligations. It should be specified that transfer pricing is of major importance in the management of a companies fiscal risk, as it may affect: tax due, cash flow, investment decisions, performance indicators, but also value at the frontier. These can be seen by transnational companies as an opportunity to deliberately and artificially obviate the payment of corporation tax.

The issue of transfer pricing is extremely complex because, in the opinion of many economic analysts, they are the central vector of the way to extend economic crime. With the expansion of the phenomenon of economic globalization, there is an increase in inter-state financial flows, generated predominantly by the transfer prices.

In fact, there are quite a lot of taxpayers who consider real transfer rates, "collecting channels" of a certain amount of important money, acquired through tax avoidance practices, more or less legal. That is why there are quite a few taxpayers who consider real transfer prices, "collecting channels", of important amounts of money, acquired through tax avoidance practices, more or less legal. Therefore, the characteristics of secure ports may result in the international under-taxation of profits, which do not respect the principle of full competition and allow it to be transferred to low-taxed states or so-called tax havens.

According to the above, safe ports can cause certain **problems of fairness and uniformity**, as two different categories of rules can be created in the field of transfer pricing: a category that complies with the principle of full competition and another that requires observance of a distinct and diminished set conditions. The solution to this issue of equity is to regulate some criteria in order to differentiate eligible taxpayers from other taxpayers who do not respect the market value principle.

Safe ports could be used to create certain transfer pricing goals, but there are some recommendations on how to use them, as they have advantages but also disadvantages. The advantages of safe ports include:

- decrease compliance and reduce compliance costs for eligible taxpayers in establishing and documenting the appropriate conditions for qualified controlled transactions;
- provide certainty to eligible taxpayers that the price charged or paid for qualified controlled transactions will be accepted by tax administrations that have adopted the safety harbor;
- helps tax authorities redirect their administrative resources from verifying lower risk operations to checking more complex risk operations;
- reduces or eliminates the possibilities for settling disputes;
- stimulates foreign direct investment.

Disadvantages consist of:

- a safe harbor in a particular country may result in the registration of a taxable income that is not in line with the principle of full competition;
- may lead to the risk of double taxation or double non-taxation when adopted unilaterally;
- potential ways of inappropriate fiscal planning are being opened up;
- may raise issues of fairness and uniformity.

Although the use of these secure ports could create a set of targets for compliance with the price transfer provisions, they could raise all the fundamental issues, as it could have a negative impact on the prices of companies engaged in regular transactions but also on revenues State taxes that implement the safe harbor. With regard to these safe ports, a number of states have adopted port security rules, and these rules have been appreciated by both tax administrations and taxpayers.

According to the above, the statutory derogations attributed to certain taxpayers in establishing the transfer prices are not considered optimal, and therefore it is not entirely recommended to use safe ports.

4. Conclusions

The issue of transfer pricing is complex for both tax authorities and multinationals, and is becoming the most important tax issue they face today. Transfer pricing is extremely important because it helps determine the taxable profits of associated companies in different tax jurisdictions. Compliance and management of transfer rates is often complex, time-consuming and costly for both taxpayers and tax authorities. However, the aspect of compliance in the field of transfer pricing should be given special attention by the tax authorities so that they can properly set their transfer pricing rules in a fair manner towards taxpayers and other jurisdictions.

It is clear from the above that safe ports raise some questions about how to determine transfer pricing, tax optimization opportunities and double taxation resulting from safe port antagonism and the arm's length principle. Although safe transfer pricing ports may conflict with the basic principles of a single jurisdiction for simple and generic operations, appropriate provisions on their use may help improve some of the tax burden and ensure greater certainty for taxpayers.

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