Tax - related risks of transfer pricing of multinational enterprises

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Abstract: With the continuous development of economic globalization, in order to meet the different needs of enterprises in production and operation, the scale of multinational companies is also increasing, and has played a certain role in economic development. The ultimate goal of an enterprise is to maximize profits, and in order to achieve this goal, multinational enterprises usually use transfer pricing to operate. Transfer pricing has both advantages and disadvantages. Although it can help enterprises reduce tax burden, it will also produce tax-related risks, and even affect the economic development of regions or countries. In view of this situation, through the analysis of the tax risks involved in the transfer pricing of multinational enterprises, some corresponding countermeasures are put forward.

Key words: transfer pricing; Transnational enterprises; Tax related

1. Introduction to transfer pricing

With the increasing use of transfer pricing, multinational enterprises will face various risks. Before risk analysis and countermeasures are put forward, it is necessary to understand the meaning of transfer pricing and the benefits that multinational enterprises can get from it.

1.1 The concept of transfer pricing

Transfer pricing of multinational companies is a method by which multinational companies, in order to maximize the overall interests of the company, conduct internal transactions to price goods, services or property between related parties within a multinational group. The price determined through transfer pricing becomes the transfer price.12 That is, multinational enterprises can adjust the distribution of corporate profits by buying or selling products or technologies from their subsidiaries at a higher or lower price than the market price, so that they can earn lower profits in regions with high tax rates and higher profits in regions with low tax rates, thus reducing corporate tax expenses and maximizing corporate profits.

1.2 The benefits of transfer pricing for multinational enterprises

Transfer pricing has many advantages for multinational enterprises, which is why multinational enterprises usually use transfer pricing. Transfer pricing more reflects the subjective will of the enterprise, in order to avoid all kinds of tax risks, reduce the operating costs of the enterprise, strengthen the supervision and assessment of subsidiaries and other purposes, and ultimately maximize the overall interests of the Group.13

First of all, transfer pricing is helpful to meet the production and operation needs of enterprises and achieve the goal of profit maximization. Transfer pricing is operated within the enterprise and can be controlled by the decision-maker of the operator. Therefore, the enterprise can transfer capital and technology within the enterprise according to its own series of business requirements and different division of labor, and at the same time, the profit of the enterprise can also be transferred to the desired extent, so as to maximize the benefits.

Secondly, transfer pricing can help multinational enterprises to avoid risks. Multinational enterprises are enterprises that need to carry out production and operation activities in two or more countries. Then there will be different tax rates, foreign exchange rates, inflation, economic policies and other factors in different countries and regions. Multinational enterprises can achieve profit transfer through transfer pricing strategy, so as to reduce the expected foreign exchange risk and thus reduce the inflation loss.14

2. Tax-related risks of transfer pricing for multinational enterprises

Multinational enterprises often transfer pricing for their own interests, and in the process there are some related risks involving tax, which will produce adverse factors for economic development.

2.1 Capital outflow risk

Tax is one of the main sources of national revenue, accounting for a large part of the revenue. The purpose of transfer pricing is to reduce the tax burden in order to meet the maximum benefit that can be obtained from the production and operation of the enterprise. Therefore, transfer pricing will cause a large amount of funds to flow to those regions or countries with low tax rates, which will cause capital outflow from those regions or countries and reduce the risk of tax revenue. Under the background of economic globalization, after multinational enterprises transfer profits to foreign countries using transfer pricing, the profits on the financial statements of domestic companies will decrease or even show losses, which will create the false impression of poor returns in the region, blow the confidence of foreign investors in the region, is not conducive to the introduction of foreign capital, reduces the possibility of investment by foreign investors, and on the contrary will lead to capital outflow and will violate the national tax incentive policy. The tax avoidance behavior of enterprises will bring great losses to the country. As a means of tax avoidance, transfer pricing is not difficult to find its greater harmfulness. Transfer pricing will greatly reduce our country's tax revenue, which will affect our country's investment in various investment and construction activities and the budget use of various funds. At the same time, transfer pricing is also contrary to the principle of fair competition in the market. It is very unfair to those enterprises that do not use this method to pay taxes in good faith. It will disrupt the normal operation of the economic market and hinder the development of the economy.

2.2 Relevant legal risks

Because transfer pricing will have adverse effects on various countries or regions, each country will adopt corresponding policies and laws and regulations to prevent enterprises from tax avoidance by various means.There are some relevant provisions in Articles 41, 43 and 44 of the latest Enterprise Income Tax Law of the People's Republic of China.

These laws clarify the obligation of affiliated enterprises to make tax returns on their affiliated transactions.Tax authorities have the right to require affiliated enterprises to provide relevant information during investigation.To a certain extent, the implementation of this tax law will hinder enterprises from using transfer pricing, and enterprises will be sanctioned by law if they operate improperly, so there are certain legal risks in transfer pricing.

3. Reasonably formulate transfer pricing strategies

While transfer pricing has both advantages and disadvantages, a series of transfer pricing countermeasures should be reasonably made to prevent risks, give full play to the positive and beneficial aspects, and better promote economic development. Enterprises can negotiate with the tax authorities by way of advance pricing arrangement, or make reasonable arrangement by way of comparable uncontrolled price method, resale pricing method, cost additive process.

3.1 Appointment of pricing arrangement

An agreed pricing arrangement is a pre-signed agreement between a taxpayer and a tax authority regarding the transfer pricing method of the related party transactions to resolve and determine the tax implications of the related party transactions in future years.15 Enterprises that meet the application conditions can reasonably implement transfer pricing by negotiating and signing an advance pricing arrangement with the tax authorities.

For tax authorities, advance pricing arrangement can reduce the cost of tax administration and make tax revenue predictable.16 Through negotiation and signing, the tax authorities will have an expectation for the future production and operation of the enterprise.For enterprises, the advance pricing arrangement can avoid the risk of special tax adjustment and avoid the penalty interest brought by the adjustment of transfer pricing afterwards. Bilateral or multilateral advance pricing can effectively avoid international double taxation, so that enterprises can focus on operation, and enterprises can also get some relative benefits through negotiation and signing.

3.2Comparable uncontrolled price method, resale pricing method and cost plus method

Comparable uncontrolled price method, resale price method and cost-plus price method are traditional and widely used pricing methods. These methods estimate international transfer prices based on the comparison of transaction behaviors in actual operation, which truly, accurately and reasonably reflect the advantages and disadvantages of multinational companies in the process of international operation.17 These are traditional transfer pricing methods based on the comparison of transaction behaviors, which have a wide range of applications and good strategic effects, and have long been favored and recognized by multinational corporations and tax departments of host countries.18

Comparable uncontrolled price method compares the price of assets or services transferred in a controlled transaction with the price of the same or similar assets or services transferred in an uncontrolled transaction under comparable conditions, that is, pricing according to the price of the same or similar business transactions between unrelated parties. Because the comparable uncontrolled price method requires finding the most comparable transaction, it is considered to provide the most reliable normal transaction information.19

Resale pricing method is a combination of price and profit. Resellers only carry out simple processing or simple purchasing and selling business, but do not carry out substantial value-added processing business for goods.20When this method encounters intangible assets, it is difficult to calculate them, so the resale pricing method is suitable for some relatively simple related transactions.

Cost additive process is the fair transaction price of related party transactions based on the reasonable cost of related party transactions plus the gross profit of comparable unrelated transactions.The key to using the cost markup method is to determine an appropriate markup rate.Generally, it is applicable to the purchase, sale, transfer and use of tangible assets, and the related transactions of providing labor services or financing.

When multinational enterprises need to use these methods to calculate the price, they need to choose the way that meets the conditions and can maximize the interests of enterprises to carry out reasonable transfer pricing according to the actual situation.

4 Conclusion

Transfer pricing is a double-edged sword, which can bring many benefits to multinational enterprises, but it is also easy to touch tax-related risks.Therefore, enterprises need to have a response to related party transactions in advance, combine local policies and regulations, and choose the way to transfer pricing that can generate the greatest benefits for enterprises according to their own conditions.According to the national conditions and the actual situation of enterprises, we should formulate a tax planning scheme that meets our own needs, pursue the maximization of enterprise value under the premise of compliance and legality, and promote the sustainable development of enterprises.21Reducing tax-related risks will also enhance the competitiveness of enterprises and promote the economic development of countries and regions.

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