Learning Corner: Transfer Pricing: What is it, and why is it relevant to Global Employment Companies?

Note: This article aims to explain the key concepts of Transfer Pricing, and it is in no way exhaustive. Readers are strongly recommended to consult a Tax Advisory firm for more detailed and specific advice.

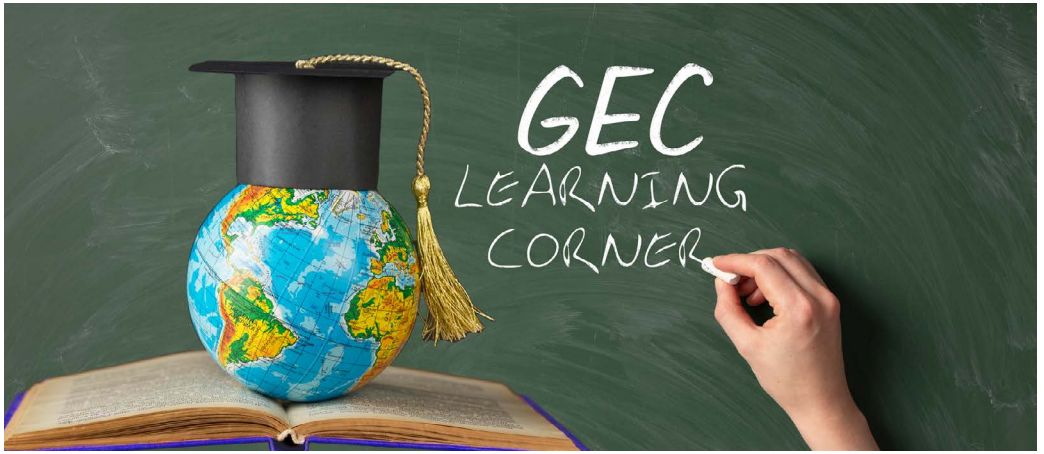
Transfer Pricing in GECs

A GEC usually acts as the legal employer of the assignees, and therefore it needs to recharge all costs to the overseas location to which the assignee is deployed, including compensation, benefits, vendor costs, and more. The GEC is also required to apply a "mark-up", or Management Fee to the overall cost recharged to the overseas subsidiary. The transaction between the GEC and the overseas subsidiary needs to comply with Transfer Pricing rules.

The concept of Transfer Pricing plays a crucial role in ensuring fair transactions between entities within the same multinational company. At its core, Transfer Pricing refers to the pricing of goods, services, or intellectual property that are exchanged between different entities of the same enterprise, often situated in different countries.

The primary objective of Transfer Pricing is to determine a fair and reasonable price for transactions between related entities, just as it would be in transactions between unrelated, independent companies. This becomes particularly important in the context of multinational corporations, where various subsidiaries or divisions collaborate and engage in cross-border transactions.

The key idea behind Transfer Pricing is to prevent entities from manipulating prices for internal transactions to minimize tax



liabilities or to shift profits to jurisdictions with lower tax rates. By establishing an arm's length principle, Transfer Pricing ensures that the prices set for goods or services exchanged internally are comparable to what would be charged between unrelated entities in an open market.

The principle of "Arm's Length"

At the heart of Transfer Pricing is the arm's length principle, which suggests that the prices set for transactions between related entities should be similar to those that would be agreed upon between unrelated entities in a similar transaction. This principle acts as a benchmark for ensuring fairness and transparency in intercompany transactions.

To implement the arm's length principle, companies often employ various Transfer Pricing methods, such as "Comparable Uncontrolled Price" (in other words, the expected market price), "Cost Plus" or "resale Price".

Failing to implement Transfer Pricing can have serious compliance implications. Therefore, organizations are required to maintain accurate records of the methods and data used to determine Transfer Pricing, and this documentation may need to be presented to the tax authorities, if necessary.

In conclusion, Transfer Pricing is a critical aspect of multinational business operations, ensuring that transactions between related entities are conducted at arm's length to maintain compliance with tax regulations, as well as financial fairness and transparency.