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KEY OBSERVATIONS ON FACTORS INFLUENCING TRANSFER PRICING PRACTICES - A COMPARATIVE REVIEW

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Abstract: *The contemporary business landscape, shaped by economic globalization, technological advancements, and increased cross-border transactions, presents both challenges and opportunities for global enterprises. Within this dynamic context, the strategic operations of multinational corporations are significantly influenced by transfer pricing decisions. This article undertakes a comprehensive exploration of the intricate factors that contribute to the shaping of TP decisions, leveraging insights from a diverse range of studies spanning multiple decades. The primary objective is to identify the factors that play a pivotal role in the decision-making process for determining transfer prices. To accomplish this aim, the authors initiated a thorough search for articles addressing the intricacies of TP decisions. These articles served as foundational resources, providing essential insights into the conceptual framework of transfer pricing. Through an analysis of existing literature, the author successfully pinpointed key factors that have been consistently recognized as having a substantial impact on the TP determination process.*

Key words: *transfer pricing, globalization, influential factors*

JEL classification: M4, H25, F23, H87

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KLJUČNA ZAPAŽANJA O FAKTORIMA KOJI UTIČU NA PRAKSE TRANSFERNIH CENA – SVEOBUHVATNI PREGLED

Sažetak: *Savremeno poslovno okruženje, oblikovano ekonomskom globalizacijom, tehnološkim napretkom i rastućim obimom prekograničnih transakcija, istovremeno je izvor izazova i prilika za globalna preduzeća. U ovako dinamičnom okruženju, na strateško poslovanje multinacionalnih kompanija značajno utiču odluke o transfernim cenama. U radu je sprovedeno sveobuhvatno istraživanje kompleksnih faktora koji oblikuju odluke o tranfernim cenama, uz uvažavanje zaključaka veoma širokog spektra studija u okviru višedecenijskog perioda. Osnovni cilj rada se odnosi na utvrđivanje faktora koji igraju ključnu ulogu u procesu donošenja odluka o utvrđivanju transfernih cena. Radi ostvarivanja definisanog cilja u radu je sprovedeno detaljno istraživanje radova koji se bave kompleksnošću odluka o transfernim cenama. Pomenuti radovi su poslužili kao osnova ovog istraživanja, pružajući suštinski uvid u konceptualni okvir transfernih cena. Analizom postojeće literature istaknuti su ključni faktori koji imaju suštinski uticaj na proces određivanja transfernih cena.*

Ključne reči: *transferne cene, globalizacija, uticajni faktori*

1. INTRODUCTION

Transfer pricing (TP) is a method used to manipulate prices, aiming to reduce companies net profits by creating the appearance of a loss to avoid tax payments (Supriyati, Murdiawti & Prananjaya, 2021). Multinational companies (MNCs) view TP as an effective strategy to achieve success in the global market competition, aiding in maximizing profits by minimizing tax payments to governments. The connection between TP and tax rules has evolved dramatically. It's not just a business metric anymore, it's become a strategic tool for MNCs. This shift emphasizes how companies must balance pricing decisions while obeying rules and making profits within legal limits. In the past, TP practices were solely used by companies to evaluate performance, but gradually, this practice has been excessively utilized by companies for profit maximization purposes. This transformation underscores the delicate balance companies must strike between pricing decisions, compliance with tax regulations, and the pursuit of legal profit maximization.

Historically used as a performance evaluation tool, TP practices have progressively shifted towards excessive utilization for profit maximization purposes.

Through an analysis of existing literature, the aim of author is to pinpoint key factors that play a pivotal role in shaping the TP determination process, shedding light on the intricate relationship between TP and strategic decision-making for MNCs.

2. LITERATURE REVIEW

The literature review captures a variety of studies, each offering a unique perspective on the intricate landscape of TP. International TP proves more intricate than domestic pricing. When dealing globally, TP decisions need to factor in both international tax considerations and the broader economic and political context, considerations that don't apply to internal, domestic transfers. While adhering to tax regulations plays a significant role in minimizing global taxes, it doesn't hold the same level of importance in domestic TP (Wu & Sharp (1979); Benke & Edwards (1980)).

Issues can arise when a company engages in both international and domestic internal transfers. In such cases, decisions are made within the same company and are shaped by many organizational characteristics. It is possible for such companies not to distinguish between international and internal subsidiaries when evaluating performance and setting transfer pricing objectives, leading to moral problems and dysfunctional behavior (Robbins & Stobaugh, 1973). Significant factors affecting the choice of a transfer pricing method can be classified as organizational, environmental, and international (Wu & Sharp (1979); Al-Eryani, Alam & Akhter (1990); Borkowski (1990)). The study also found differences in decision-making processes between domestic and MNCs. MNSs tend to place a greater emphasis on global consistency and compliance with international regulations, while domestic companies focus more on minimizing tax obligations and maximizing profitability.

The research conducted by Al-Eryani, Alam and Akhter (1990) analyzed the determinants of TP strategies used by U.S. based MNCs. The study aimed to understand the factors influencing the TP decision-making process in MNCs. The authors collected data from 121 U.S. based MNCs using a questionnaire and personal interviews with financial directors. The data were analyzed using multiple regression analysis, and the results showed that the size of subsidiaries, the host country's tax rate, and the degree of product differentiation were significant determinants. The study found that larger subsidiaries tend to have higher levels of TP, possibly due to their greater negotiating power with the parent company. Furthermore, the study indicated that the tax rates in the host country influence TP decisions, as companies tend to reduce TP in countries with higher tax rates to lessen their tax burden.

Ultimately, it was observed that the degree of product differentiation significantly influences TP, as companies with highly differentiated products tended to have higher TP.

Borkowski's (1992) study explores the factors influencing companies decision-making processes when selecting a TP method. The study involved interviews with tax professionals from both domestic and multinational companies. Establishing TP requires the company's management to evaluate both internal and external operating environments before selecting the most suitable TP method.

Researchers Lin, Lefebvre and Kantor (1993) identified several factors influencing TP decisions, including tax rates, TP regulations, the relative cost of production in different countries, and the level of market competition.

Borkowski's (1996) study aims to identify key factors influencing TP practices and the research methods used to investigate these practices. The study employs a meta-analysis methodology, involving the analysis and synthesis of findings from previous TP studies. The author analyzes 112 articles published in academic journals and categorizes them based on research methodology. The study finds that TP practices are influenced by various factors, including tax laws and regulations, the complexity of TP rules, the risk of penalties and audits, and the availability of information. The study also highlights the importance of organizational factors, such as the structure of MNCs, the role of subsidiaries, and managerial motivations.

Research methods used to investigate TP practices include case studies, experimental models, and econometric models. The study notes a lack of standardization in research methods and a need for more comparative studies to identify best practices in TP. The study also emphasizes the necessity of interdisciplinary research that integrates accounting, economic, and legal perspectives to provide a comprehensive understanding of TP practices. Future research is recommended to focus on the effectiveness of TP regulations, the impact of TP on tax revenues, and the implications of TP for economic development.

In 1997, the author reviews existing literature on TP and income shifting, presenting a conceptual framework that identifies factors influencing TP decisions. The framework includes factors such as tax rates, exchange rates, market conditions, and regulatory environment. The author also discusses the role of TP in international taxation and presents various TP methods that can be used to allocate profits among affiliated parties. To test the hypotheses derived from the conceptual framework, the author conducted a survey on 65 Canadian and American multinational corporations. The survey questionnaire included questions about TP policies, factors influencing TP decisions, and the extent of income/profit shifting. The author analyzed the survey data using descriptive statistics and regression analysis.

The study by Cox, Howe and Boyd (1997) found that TP can have significant effects on locally measured organizations, especially in terms of profitability and investment decisions. Researchers identified several factors influencing these effects, including the size and complexity of the organization, intra-firm trade levels, and the degree of decentralization in decision-making.

Furthermore, the study showed that TP practices can also have implications for managerial control and performance evaluation. Researchers suggested that local managers may be incentivized to adopt opportunistic behavior, such as minimizing reported profits, to avoid negative performance evaluations and penalties.

Oyelere, Peter, Emmanuel and Forker (1999), investigate the impact of environmental factors on TP decisions of MNCs in the United Kingdom. The study used a sample of 79 MNCs, consisting of 40 foreign-controlled companies and 39 UK-controlled companies. The authors used a questionnaire and conducted interviews with tax and finance directors of MNCs to collect data on their TP practices and the environmental factors influencing their decisions.

The study found that environmental factors such as tax laws, regulations and enforcement, political stability, exchange rates, and market competition significantly affect MNCs TP decisions. However, the impact of these factors varies between foreign-controlled and UK-controlled companies. Foreign-controlled companies have proven to be more sensitive to tax laws and regulations and exchange rates, while UK controlled companies have been more sensitive to market competition and political stability. The authors suggest that this may be due to differences in ownership structure and objectives between the two groups of companies.

The research conducted by Bartelsman and Beetsma (2003) aimed to investigate corporate tax evasion through TP in OECD countries. The study employed an empirical research method using data from MNCs in OECD countries. According to the study, MNCs engage in strategic TP to reduce their tax obligations. This behavior is more prevalent among companies with high levels of intangible assets, such as patents and trademarks, and among firms operating in countries with high corporate tax rates. Researchers also found that TP strategies can have significant implications for government revenues, with estimates suggesting that TP can reduce government revenues by up to 20% in some countries.

Chan, Landry and Jalbert (2004) explore the impact of exchange rates on international TP decisions. The study focuses on the effect of exchange rate fluctuations on the prices of goods and services transferred between affiliated entities in different countries. The authors argue that exchange rate fluctuations can create opportunities for TP manipulation by MNCs to transfer profits to jurisdictions with lower taxes or to avoid taxes altogether.

The study uses a case study approach to examine the impact of exchange rate fluctuations on TP decisions in a MNCs operating in the automotive industry.

Chan's article (2005) explores the effectiveness of government regulations in preventing TP manipulation by MNCs in Hong Kong. The study uses a quantitative research methodology using a survey to collect data from a sample of 158 MNCs in Hong Kong. The survey included questions about the TP practices of companies, their compliance with government regulations, and the effectiveness of regulations in preventing TP manipulation.

The study finds that government regulations have a limited impact on preventing TP manipulation. MNCs can find ways to circumvent the rules, such as using different pricing methods or transferring profits to low-tax jurisdictions. The study suggests that the effectiveness of government regulations is influenced by several factors, including the level of enforcement, the complexity of TP rules, and the ability of companies to take advantage of differences between tax regimes in different countries.

The aim of the study by Doğan, Deran and Gül Köksal (2013) was to identify factors influencing the selection of TP methods and the determination of TP in MNCs operating in the United Kingdom. The authors conducted a survey of MNCs operating in the UK, including both qualitative and quantitative data. The survey was sent to 121 MNCs, and 57 responses were received. The survey included questions related to the company's TP policy, factors influencing the selection of TP methods, and factors influencing the determination of TP. The results of the study showed that the most frequently used TP method in the UK was the comparable uncontrolled price method, followed by the cost-plus method and the resale price method. The factors that proved to be most influential in selecting TP methods were the availability of comparable data, the complexity of the product or service, and the level of market competition.

Regarding the determination of TP, the results showed that the most important factor was the arm's length principle (ALP), which requires TP to be set at a level perceived between two unrelated parties in an open market. Other important factors included the need to comply with tax regulations.

The research conducted by Wang, Gao and Mukhopadhyay (2013) aimed to investigate the impact of taxation on international TP and "offshoring" decisions. The study used a theoretical research method employing a mathematical model to analyze MNCs behavior in response to tax regulations.

The study found that taxation plays a crucial role in determining TP and offshoring decisions of MNCs. Researchers identified several factors influencing these decisions, including tax rates, TP regulations, and the relative cost of production in different countries.

Furthermore, the study found that fiscal policies can have unintended consequences on the economy, such as reducing workforce employment and decreasing domestic production.

Researchers suggested that decision-makers should consider the long-term impact of fiscal policies on the economy and promote transparency in TP practices to prevent tax evasion.

The research conducted by Richardson, Taylor and Lanis (2013) aimed to investigate the determinants of TP aggressiveness among Australian companies. The study used an empirical research method with a sample of 296 Australian firms over a four-year period.

According to the study, Australian companies engage in TP aggressiveness to reduce their tax obligations. Researchers identified several factors influencing these decisions, including firm size, foreign ownership, profitability, debt level, and the effective tax rate. Additionally, the study showed that TP practices can have significant implications for government revenues, with estimates suggesting that TP can reduce government revenues by up to AUD 4.7 billion annually in Australia.

Waworuntu and Hadisaputra (2016) explore the factors determining TP aggressiveness in Indonesia. TP aggressiveness occurs when MNCs use TP to transfer profits from high-tax countries to low-tax countries to minimize their tax obligations. The authors used data from 173 firms listed on the Indonesia Stock Exchange and conducted a regression analysis to identify the determinants of TP aggressiveness. The study found that firm size, leverage effect, tax incentives, and the presence of transactions with affiliated parties were significant determinants of TP aggressiveness in Indonesia. The results indicate that larger firms tend to be more aggressive in their TP practices, consistent with previous research. The study also found that tax incentives offered by the Indonesian government to attract foreign investments may encourage MNCs to engage in more aggressive TP practices.

The study emphasizes the importance of monitoring regulations to prevent excessive TP aggressiveness, especially in the context of emerging economies such as Indonesia. The authors recommend the Indonesian government to strengthen its TP regulations and enforcement mechanisms to ensure that companies do not engage in abusive practices that harm the country's tax base.

The study by Ossipov and Sokolov (2019) provides important insights into the impact of the size of a MNCs on the choice of TP methods. The findings suggest that larger MNCs tend to use more complex TP methods, leading to higher reported profits. It also underscores the importance of considering industry-specific factors when choosing a TP method.

The study by De Simone, Di Maria and Pazzaglia (2019) relied on financial data from over 2,000 Italian companies and used a combination of quantitative and qualitative analyses to evaluate the use of TP in their business practices. The results of the study showed that most companies use the comparable uncontrolled price method to establish TP.

Additionally, the size of the company, the degree of internationalization, and the industry in which it operates were identified as important factors influencing the choice of TP method. The study concluded that TP is widely used by Italian companies, and the comparable uncontrolled price method is the most commonly used method.

The study by Tóth and Zsidó (2020) is based on a survey of 67 MNCs in Hungary and uses logistic regression analysis to test the influence of various factors on the choice of TP methods. The results indicate that MNC size, industry type, intra-group transaction levels, and fiscal risk significantly affect method selection. MNCs with higher fiscal risk are more likely to use the comparable uncontrolled price method or the cost-plus method, while those with lower fiscal risk tend to use the resale price method or profit-split method. The authors suggest that the findings could help MNCs and tax authorities better understand the factors influencing TP decisions and develop more effective regulations.

Nurwati, Prastio and Kalbuana (2021) investigates the impact of company size, exchange rates, profitability, and tax burden on transfer pricing practices in Indonesia. The study uses a sample of 71 publicly listed manufacturing firms on the Indonesia Stock Exchange.

In practice, TP is also utilized by MNCs for tax strategy. Business decisions, whether direct or indirect, are often influenced by taxes, and there will be differences in interests between companies as taxpayers and the government. Tax planning is a means to ensure that there is no excessive payment of taxes, and it is not considered tax avoidance as long as it is done in accordance with applicable tax laws.

The research conducted by Issah, Antwi, Amatus and Borawa (2022) aimed to investigate the factors influencing the selection of TP methods and the determination of TP in MNCs in Ghana. The study used a qualitative research method employing a case study approach, with data collected through interviews and document reviews.

The study found that MNCs in Ghana consider multiple factors when selecting

TP methods, including the nature of the transaction, data availability, and the level of documentation required. The research also identified some challenges faced by MNCs in Ghana in determining TP, including the lack of reliable data and the complexity of regulations. It was also noted that TP documentation is essential for MNCs in Ghana to comply with TP regulations.

3. METHODOLOGY

Diverse methodologies characterize the studies under review. From qualitative approaches like interviews and surveys employed by Al-Eryani et al. (1990) and Dogan et al. (2013) to mathematical models adopted by Wang et al. (2013) and empirical research methods in studies by Cox et al. (1997) and Richardson et al. (2013), each methodology contributes to a nuanced understanding of TP decisions.

Table 1

Factors Influencing Transfer Pricing – A Synthesis of Studies

Authors	Influencing factors	Methodology
Al-Eryani, M. F., Alam, P., & Akhter, S. H. (1990)	Negotiating power, company size, tax rates, degree of product differentiation	Questionnaire and interviews with practitioners
Borkowski, S. C. (1992)	Company/branch size, industry, economic stability, transfer size, compliance with tax regulations	Interviews with tax directors
Lin, L., Lefebvre, C., & Kantor, J. (1993)	Tax rates, transfer pricing regulations, relative production cost, market competition level	Mathematical model to analyze the behavior of MNC
Borkowski, S. C. (1996)	Tax regulations, risk of penalties and audits, availability of information, MNCs structure, role of subsidiaries, motivations of managers	Meta-analysis
Borkowski, S. C. (1997)	Tax rates, exchange rates, market conditions, and regulatory environment	Survey of 65 MNCs in Canada and America
Cox, J. F., Howe, W. G., & Boyd, L. H. (1997)	Size and complexity of the organization, degree of decentralization in decision-making	Survey conducted on 88 companies in the U.S

Oyelere, Peter B., Emmanuel, C. R., & Forker, J. J. (1999)	Tax regulations, market competition, availability of expertise, tax rates	Quantitative and qualitative method
Bartelsman, E. J., & Beetsma, R. M. W. J. (2003)	Tax regulations	Empirical research using data from MNCs in OECD countries
Chan, C., Landry, S. P., & Jalbert, T. (2004)	Exchange rate fluctuations	Explores the impact of exchange rates on international transfer pricing decisions
Chan, C. (2005)	Governmental/fiscal regulations	Survey of 158 MNCs in Hong Kong
Doğan, Z., Deran, A., & Gül Köksal, A. (2013)	Tax rates, financial reporting standards, exchange rates, inflation rates, performance criteria, company size	Questionnaire/survey – 121 companies in the UK
Wang, Z., Gao, W., & Mukhopadhyay, S. K., (2013)	Taxation, tax rates, tax regulations	Mathematical model
Richardson, G., Taylor, G., & Lanis, R. (2013)	Size of the firm, foreign ownership, profitability, level of debt, and effective tax rate	Empirical research method involving a sample of 296 Australian firms
Waworuntu, S. R., & Hadisaputra, R. (2016)	Company size, leverage effect, use of tax havens	Quantitative analysis – regression
De Simone, L., Di Maria, E., & Pazzaglia, F. (2019)	Company size, degree of internationalization, and industry	Over 2,000 Italian companies, a combination of quantitative and qualitative analyses
Ossipov, A., & Sokolov, V. (2019)	The industry in which the MNC operates, tax regulations	Quantitative approach involving the collection of data from financial statements and other public sources of information for 270 MNCs

Tóth, B., & Zsidó, G. (2020)	The size of the company, industry type, level of intra-group transactions, and degree of tax risk	A survey conducted with 67 MNEs in Hungary utilizing logistic regression analysis
Ossipov, A., & Sokolov, V. (2019)	The size of the company, exchange rates, profitability, and tax burden	100 manufacturing firms
Issah, M., Antwi, S., Amatus, Z., & Borawa, H.A.R. (2022)	Transaction nature, data availability, and required documentation level	Ghana, a case study, with data collected through interviews

Note. Own research.

4. RESEARCH DIRECTIONS

Future studies may delve into how international organizations play an evolving role in shaping transfer pricing (TP) practices. By examining initiatives aimed at globally standardizing TP regulations, researchers can highlight both the potential benefits and challenges faced by multinational corporations.

Another avenue for exploration involves understanding the connection between environmental, social, and governance (ESG) considerations and TP decisions. As businesses increasingly emphasize sustainability, investigating how these factors interact with TP strategies can offer valuable insights for companies and regulators.

In proposing practical research, we intend to examine factors identified in existing literature and introduce new variables, such as a country's corruption index. Focusing on European countries, this study aims to not only contribute to current knowledge but also uncover fresh insights into the dynamics of TP decision-making.

5. CONCLUSION

In conclusion, this comprehensive exploration of TP decisions unravels the intricate dynamics that companies navigate in their pursuit of optimal transfer pricing strategies. The synthesis of studies highlights negotiating power, company size, tax rates, and regulatory compliance as pivotal factors influencing TP decisions. Moreover, the adaptive nature of TP strategies in response to dynamic economic conditions underscores the importance of a nuanced, context-specific approach.

As we reflect on the diverse perspectives offered by these studies, it becomes evident that transfer pricing is not a static, one-size-fits-all concept. Instead, it represents a dynamic interplay of internal and external factors that demand continual assessment and adaptation.

The synthesis of these studies not only contributes to academic understanding but also provides practical insights for businesses, policymakers, and tax authorities grappling with the complexities of transfer pricing in a globalized economy.

Moving forward, the findings from this synthesis call for continued interdisciplinary research that integrates accounting, economic, and legal perspectives. This holistic approach is essential for developing comprehensive frameworks that address the evolving challenges and opportunities in transfer pricing.

By embracing this complexity, businesses can navigate the intricate terrain of transfer pricing with greater resilience and foresight, ultimately contributing to more robust economic systems and fair fiscal practices.

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