Bulletin of the *Transilvania* University of Braşov
Series V: Economic Sciences • Vol. 8 (57) No. 2 - 2015

Transfer pricing. Fiscal and accounting treatments

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Abstract: *This paper presents brief assertions on the issue of the transfer pricing and their fiscal and accounting treatment. The concept refers to the transactions between affiliated parties, namely aims at those transactions that are not exclusively governed by the rules of the free market, also considering other influence factors such as: the policy of the group of entities related to the minimization of the fiscal cost at the group level. The aimed goals are both fiscal and accounting and they see to the thoroughgoing study of the issues of the implications of practicing transfer pricing between the affiliated entities.*

Key-words: *transfer pricing, file of the transfer pricing, accounting treatments, fiscal treatments.*

1. Introduction

The development of the market economy, the internationalization and the globalization of business and especially the fact that most of the transaction are carried out between economic entities of the same group imposed the need of knowing and thoroughgoing study of the concept of „***transfer pricing***".

The term of ***"transfer pricing"*** is found in the approach of the study of the transactions between affiliated parties (that is *transactions between the parties of the same group,* defined according to art. 7, paragraph 1, point 21 of Law 571/2003 on the Tax Code, with subsequent amendments and completions), regardless if the object of the transactions is the transfer of goods or intellectual property rights, the execution of services or other types of transactions. The operations between the affiliated parties must be carried out subject to the principles of the ***market value.***

The principle of the market value requires that the prices used in the transactions between the group entities *are equal* to those that would be practiced between independent parties in similar circumstances. Yet, practice showed that the prices used between affiliated parties may derogate from the basic rules offering the group the possibility to distribute the the profits and the losses between the entities

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depending to the goals aimed at. A multinational company closely takes into consideration the tax regulation in every country where the group does business.

From the point of the fiscal authorities, the taxation of the real profits obtained by the local branches from the transactions with the affiliated parties represents an approach which is prioritized and strictly observed. The fiscal authorities have the right to make adjustments, according to art 3, paragraph 2 of the Order of the Ministry of Public Finances no. 222/2008, order on the content of the file of the transfer pricing if the practiced prices do not comply with the principle of the market value.

2. Research methodology

The goals of the study aim at:

- ✓ Identifying the fiscal obligations generated by the transactions between the affiliated parties;
- ✓ Presenting the methods to determine the transfer prices;
- ✓ Drafting the transfer prices file;
- ✓ Analyzing certain fiscal issues on the impact of the transfer process on the VAT.

In order to reach the goals proposed within the research, the scientific approach substantiates on a qualitative approach (qualitative study), method that orients to the thoroughgoing study of the theory elements. In this context we documented on the grounds of the legal regulations in the field and we analyzed the content of specialty works.

The theoretical information and knowledge are used in order to obtain the comprehensive character of the phenomena related to the ***transfer pricing.***

3. Results and Discussions

3.1. Methods to determine the transfer pricing

To document the transfer pricing we use various methods. These are analytical instruments to determine and evaluate the market value of the transactions carried out between the affiliated parties. Both the economic entities and the fiscal entities use these methods. The Romanian laws (art. 11 point 22-41 of the Government Decision no. 44/2004 on the Methodological Norms of the Tax Code enforcement published in the Official Journal no. 112/06.02.2004, with subsequent changes and amendments) refer to ***five methods*** of determining the transfer prices strictly correlated to those stipulated by the OECD (***Organisation for Economic Co-operation and Development)*** Guide. The methods are presented in the following table:

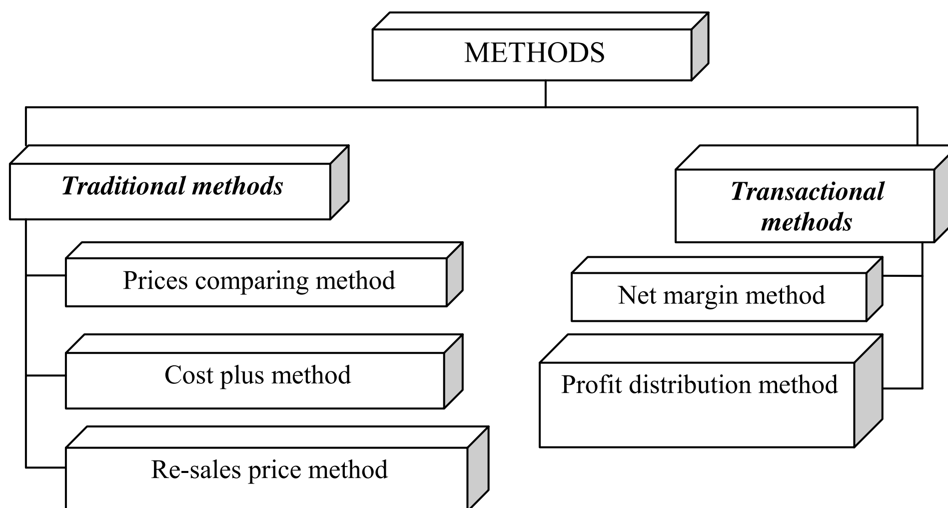

Fig. 1. ***Methods to determine the transfer pricing***
(Source: Adrian Luca, Transfer prices, "Consultant fiscal" magazine, no. 6/2009, p. 20)

The traditional methods include: ***the prices comparison method*** that requires the comparison of the prices practiced to those of similar transactions, ***the cost plus method*** that substantiates on the comparison of the profit gross margin obtained in excess of the costs level and the ***resale price method*** compares the gross margins of the sales.

The transactional methods substantiate on the determination and comparison of the ***profit net margin*** obtained by the group of companies to the profit net margins obtained by independent entities from similar activities and, furthermore, on the ***method of profit division*** that substantiates on the agreed profit obtained by the affiliated parties after the transactions and its division between the participants depending on the contribution of each of them. The OECD guide leaves the freedom of choosing other methods to determine the transfer pricing provided that they observe the market value principle and the taxpayer justifies the choice of the method by the appropriate documentation.

The identification of the most appropriate transfer method considers the best estimation of the market value in the given circumstances. The choice of the method differs from a company to another and the opportunity to apply each of them is influenced by the features of the studied transactions.

3.2. The file of the transfer pricing

According to ***art. 19 (5) of the Tax Code*** "the transactions between the affiliated parties must comply with the principle of the free market price....To determine the profits of the affiliated parties we must take into account the principles of the transfer pricing". Upon the request of the fiscal authorities, the taxpayers making transactions with the affiliated parties, in order to determine the transfer pricing, according to ***art. 79 paragraph 2 of the Government Order no. 92/2003*** on the *Fiscal Procedure Code*, republished with subsequent changes and amendments must draft and present the ***transfer pricing file*** within the set deadlines.

The content of the file was approved by the ***Order no. 222/2008*** issued by the National Agency of Tax Administration published in the Official Journal no. 129/08.02.2008.

The transfer pricing file ***must be drafted*** both for transactions made between a resident affiliated party and a non resident affiliated party and for the transactions concluded between affiliated Romanian legal entities.

It is structured in two chapters that include A. *Information on the group and B. Information on the taxpayer.*

3.3. Transfer Pricing. Fiscal and Accounting Principles

According to the fiscal regulations, the taxpayers of the affiliated party that conclude intra-group transactions must observe the following fiscal obligations, such as:

- ✓ Drafting the transfer pricing file regulated by the Order of the Ministry of Public Finances no. 222/2008;
- ✓ Determining the methodology to decide the transfer pricing;
- ✓ Observing the deadline for the provision to the fiscal authorities of the transfer pricing file, if requested, according to art. 79 paragraph 2 of the Government Order 92/2003 on the Fiscal Procedure Code, with subsequent changes and amendments;
- ✓ Drafting the supporting documents underlining the effective execution of the services;
- ✓ Issuing the invoices for the delivery of the goods;
- ✓ Outlining the deliveries invoices in the Sales Register;
- ✓ Outlining the purchase invoices in the Purchases Register;
- ✓ Drafting the VAT returns (D300) and the informative Statement on the deliverables/execution and the purchases on the national territory (D394);
- ✓ Drafting the fiscal records;
- ✓ Drafting the profit tax declaration (D101);
- ✓ The payment of the fiscal debts at the deadlines and the specific amounts determined; Other fiscal obligation stipulated by the Fiscal Code.

3.3.1. Sizing the Transfer Pricing and the Implications on the VAT

The adjustment of the transfer pricing to comply with the market value reflects on the ***profit tax,*** by the reconsideration of the incomes and of the expenses pertaining to the transactions made between the companies within the group and on the ***taxable basis related to VAT.*** By the Government Order no. 8/2013 to change and complete Law no. 571/2003 on the Tax Code, art. 137 of the Tax Code is amended related to the taxation basis of the value added tax, namely that it is made up of:

„*e) for the delivery of goods or for the execution of services whose beneficiary is an affiliated party of the supplier/ provider according to art 7. paragraph 1, point 21, the taxation basis is considered the market value in the following circumstances:*

1. *when the counterparty is less that the market value and the beneficiary of the of the delivery or of the execution does not have a complete right of deduction, according to the provisions of art. 145, 1451 and 147;*

2. *when the counterparty is less that the market value and the supplier or the provider does not have a complete right of deduction, according to the provisions of art. 145 and 147 and the delivery or the execution is exempted according to art. 141;*

3. *When the counterparty is more than the market value and the supplier or the provider does not have a complete right of deduction, according to the provisions of art. 145 and 147"*.

The European Laws on the VAT stipulate that the taxation basis for the delivery of a good or for the execution of a service for good and valuable consideration, the value the parties agreed on in the transaction shall be taken into consideration. Despite this, the stipulations of art. 80 of the Directive 2006/112/CE on the common VAT system, for the prevention of the tax evasion or of fraud for the EU member states aims at the possibility of adopting measures by which to impose that the VAT taxation basis for the operations between the affiliated parties is equal to the market value of the goods/ services purchased/delivered but only if the one of the parties involved in the transaction ***does not have complete right of deduction*** (in Romania the regulation in enforced by Law no. 571/2003 on the Tax Code).

The operations of delivery of goods/ execution of services between the affiliated parties (Grigore 2012, 17), with complete right of VAT deduction, either at a bigger price than the market price influencing the taxation basis for the VAT is not subject to the tax evasion law.

Therefore, in these circumstances there are no restrictions as far as the taxation basis is concerned. The impact of the transaction below the market price is on the taxable basis for the determination of the profit tax.

It can be a loss in term of the VAT cashing up at the state budget if in the transaction there is also an entity that does not have the complete right to deduct the VAT and the price is artificially increased or diminished.

In practice, there are cases when the price used by the parties is significantly decreased/increased compared to the market value of the goods/services representing the object of the transaction and, as applicable, the taxpayers must collect, after fiscal inspections, the deducted input VAT for the difference between the market value and the effective sales price.

For example, we consider *the company X SA which is VAT registered purchases goods amounting to 20.000 lei and VAT of %, that it resells after a while to an affiliated party, considering the following hypotheses:*

1) *The beneficiary of the delivery or of the execution does not have a complete right of deduction and the delivery is made at the value of 15.000 lei* and *VAT of 24%.*

In these circumstances, the use of a smaller price between the affiliated parties ***totally determines an oversized deduction of the VAT***, as the supplier deducts the value pertaining to its purchases at a real price (bigger), collects a smaller tax and the beneficiary who does not have the right to deduct has a smaller VAT amount which is not deducted.

The accounting records are:

a. The purchase of goods on the grounds of an invoice from an internal provider:

%	=	401 *"Suppliers"*	24.800
371 *"Goods purchased for resale"*			20.000
4426 "*Input VAT"*			4.800

b. The invoicing of the goods to the affiliated goods at a smaller value than the market value:

4111 *"Customers"*	=	%	18.600
		707 "*Sale of goods purchased for resale"*	15.000
		4427 *"Output VAT"*	3.600

In this hypothesis, the affiliated company has non deducted VAT of 1.200 lei, recovered by the supplier company from the collected VAT (effectively, from the state budget).

2) *The supplier or the provider does not have a complete right to deduct and the delivery shall be at the value of 25.000 lei* and *VAT of 24%*

The use of a larger price than the market value between the affiliated parties when the supplier does not have a complete right of deduction determines the ***transfer to the affiliated beneficiary of the right to deduct for a larger value so that it can set off or even exceeded the value non deducted by the supplier.***

The accounting records are:

a. Invoicing of the goods to the affiliated party at a larger value than the market value:

4111 *"Customers"*	=	%	31.000
		707 *" Sale of goods purchased for resale"*	25.000
		4427 *"Output VAT"*	6.000

In these circumstances the fiscal inspection authorities monitor the adjustment of the transfer pricing practiced by the group companies.

Therefore, we notice that the artificially reduced or increased price can generate a fiscal loss only if the final beneficiary of the transaction has the limited right to deduct VAT.

3.3.2. The Fiscal and Accounting Treatment of the Guarantees in the Context of the Transfer Pricing

The guarantee represents an accessory relationship to the "crediting" relationship and requires the existence of three parties: the creditor, the debtor and the guarantor. The main operation is the granting of a loan (credit) to an entity called "debtor" by an entity called "debtor" on the grounds of which the debtor pays the creditor a remuneration. The guarantor is the person undertaking the obligation that if the debtor cannot return the loan remunerates the creditor to cover the created damage. For the undertaken risk, the guarantor receives an amount according to an agreement between the parties.

In practice there are several types of guarantees found: guarantees for the leasing agreements, guarantees for the delivery of goods, guarantees (bonds) for the executions of obligations and contract terms (for the constructions agreements, lease agreements) etc.

The most encountered form is the one of loan agreements guarantees and if the affiliated parties are involved the transfer pricing issues must be considered (Luca 2010, 32).

From the point of view of the economic content, the guarantees create a financing cost for the person whose obligations are guaranteed and, therefore, the relationship must be interpreted as a ***loan***. The assertions of specialists in the field consider an assimilation of the guarantees to the category of the services provided by an entity (affiliated party or not) to another person, registering expenses for this economic category.

Considering the transfer pricing, in the argumentation of the ***need to provide guarantees to the affiliated parties*** we must take into consideration the need to redress their financial situation as the impossibility to obtain a credit from the credit institutions.

Moreover, we also studied the motivation that such circumstances would determine more advantageous conditions, namely a lower interest rate. In this context the benefit thus obtained could cover the cost of the guarantee and would generate a profit percentage.

4. Conclusions

The issue of transfer pricing incites both from the point of view of the situations and by their diversity. It must be approached and documented by the companies by the transfer pricing policies long before the transactions with the affiliated parties take place. The transfer pricing are prices of the transactions between the affiliated parties (entities that are part of a national or multinational group of companies). Considering that the transfer prices are determined between two entities controlled by the same natural person/legal entity, the question of the existence of the interest of minimum sizing of the fiscal taxation at the group level and of the breach of the commercial and financial conditions on the grounds of which the transactions would have been carried out between independent entities raises. Therefore, they have to be rigorously documented so that the profit of the group is allotted between the states where the companies of the group have their registered offices and the taxation is for the part of the profit registered by each entity in that state.

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