THE PROBLEMS OF TRANSFER PRICING

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Abstract

Each item has a price, but not every company is able to independently set the price at which it wants to sell its goods. Firms need to have a streamlined method of setting prices for their goods, and their financial condition depends on it. When choosing a method of pricing, there must be considered and internal and external constraints. The paper discusses the stages of formation of prices in a continuous process of pricing, as well as methods of pricing, their advantages and disadvantages. This paper includes interesting information about the transfer pricing and its interrelationship with tax issues in terms of world economy and Uzbekistan. Author tried to describe need of transnational corporations and holding companies for transfer pricing and potential of Uzbekistan to develop and regulate transfer pricing. There were written some key issues for implementation of tax issues in terms of world economy and Uzbekistan. Availability of two things – systematic approach and principle of system is characterized as main condition to regulate transfer pricing. Author approached to transfer pricing as a tool which plays an important role in effective regulating transnational corporations' activities in Uzbekistan. It’s notable that legislation issues of transfer pricing were also described. Paper shows the basic results of research aiming to investigate transfer pricing issues in Uzbekistan. Availability of two things – systematic approach and principle of system is characterized as main condition to regulate transfer pricing.

Keywords: Pricing, Transnational corporations, Tax, National legislation

Transfer Pricing and Tax: The use of transfer pricing, carried out in various ways and means, referred to as tax planning, which is an integral part of the management activities of large corporations. Although, if we consider this mechanism from the perspective of the state we can say that it is a tool to avoid tax. The structure of the instruments to avoid tax is more significant in countries where the possibility of tax evasion is limited. The need for complex mechanisms of tax planning is absent in those jurisdictions where legal climate provides opportunities to minimize taxes without significant risk when tax evasion is relatively cheap. Transfer pricing (price distortion transactions) as a way to avoid (minimize) the tax is typical for the almost all countries of the world. As a result of the application of standards to reduce the tax burden due to price manipulation, the state loses due tax payments that would have received in the case of utilization of right (free) prices by taxpayers.

As a rule, the transfer prices are used within groups of interdependent companies. For example, the mining holding company sells its products to sales companies belonging to the same holding, at a lower price, and sales company in turn sells the goods to final consumers at market price. Price of sales of products between the companies is considered as transfer price.

Indeed transfer pricing can significantly save on taxes, using calculations of intracorporate price. However, transfer pricing, first and foremost - it is an objective requirement of the market and a powerful stimulus for economic development. For example, in case of the same mining company, the whole cycle, from the process of production to selling to end consumers, divided into many stages, but single leadership is responsible for the implementation of each of them. The effectiveness of the particular unit, for example, sales at such business organization is not clear. As a consequence, it is more
Transfer Pricing in Uzbekistan: Although today, there's sufficient number of units of transnational corporations extensively using transfer pricing mechanism in the Republic of Uzbekistan, in the Uzbek legislation the term “transfer price” has not used yet. Moreover, the existence of free economic zones in the individual states is a powerful incentive for the use of such a mechanism.

However, the Uzbek legislation does not prohibit the use of transfer prices. According to article 356 of the Civil Code of the Republic of Uzbekistan implementation of the contract is paid at a price fixed by agreement. At the same time the Tax Code does not provide for determining the market price, nor the provisions on transfer pricing. As a result, nowadays in Uzbekistan because of the lack of the legal framework governing the transfer pricing there is a practice of understatement the market value of the goods (works, services). Because of such conditions, the state budget loses tax revenue. In the case of acceptance appropriate legislation, the tax authority finding out the fact of use of transfer pricing, could claim in court invalidation of the transaction in accordance with Article 124 of the Civil Code of the Republic of Uzbekistan. As a result, business entities rarely would use transfer prices that will allow the state to fill its budget.

Transfer Pricing in Global Economy

At present, the legal regulation of transfer pricing has been done at the international level through agreements on avoidance of double taxation and at the national level by the rules of domestic tax legislation. In this case, the regulation of transfer prices is to ensure that the tax authorities should not aim to eliminate transfer pricing, and find out whether or not it leads to minimize tax liabilities. Exploring the scope of the rules governing transfer pricing, by type of tax, it is noted that in majority countries they are applied to taxes on income (profit). At the level of the International Society of the Organization of Economic Cooperation and Development for this purpose there have been developed so-called “arm’s length principle”.

The essence of this principle is that the interdependent companies (for example, companies of the same holding company) use prices different from market in maintaining their relations, independent companies (located from each other “at arm’s length distance”) use market prices. The state, in turn, corrects such non-market prices as if the companies were independent. This principle finds its incarnation at the level of international agreements and intra-national norms. Most of the agreements on avoidance of double taxation contain articles on the adjustment of profits of associated enterprises. For example, Article 9 of the Agreement between the Government of the Russian Federation and the Government of the Republic of Uzbekistan for the avoidance of double taxation of income and property from the 2nd March 1994 states that it is possible to additional taxation in cases when the associates of Contracting States apply prices other than market prices. This rule was formulated as follows: “...if the entity is an associate and in any case there are appeared or set situations between enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then the profit that would have been credited to one of the enterprises, but because of the presence of such relations have not so accrued, may be included in the profits of that enterprise and taxed accordingly”.

Conclusion

In general we can say that at the present time, the use of transfer pricing has been done quite freely in various countries and the Republic of Uzbekistan is no exception. Considering the creation of the free industrial zone in Navoi region, it is believed that the practice of transfer pricing will be expanded. Consequently, it is very important for Uzbekistan to take the appropriate legal framework to adequately reflect the negative impact of the use of transfer pricing within the holding companies and transnational corporations presenting in the territory of the Republic of Uzbekistan.

References


