Abstract: In determinate the transfer prices, The Romanian Procedural Fiscal Code stipulates (in the 79th article) the obligation for those contributors who make transactions with related entities to draw up a record of transfer prices and to forward it to the tax administrations (at their request).

Currently, the UE member states seek harmonization of tax legislation, with the aim of creating a common tax base. An important effect of the common base would be giving up the requirement for compiling a transfer price record, because the realization of income in a member state shall be associated with expenses in the state where the affiliate is located.

In Romania, the guidelines on transfer pricing developed by the OECD have been assimilated into the domestic tax regulations (although our country is not yet a member of OECD), in order to harmonize these regulations in the Community.

The main effect globalization has on transfer prices is increasing their complexity, as, in fact, economic globalization is reason for the existence of transfer pricing. With the increasing complexity of this area, states are forced either to improve legislation, or to create it, in order to ensure the growth of states income taxes.

Cuvinte cheie: Globalization, Transfer pricing, Transfer pricing record, “Arm’s length” Principle, Tax authorities, ANAF

In the current global context, international economic growth is based on cross-border commerce, which most times consists on intra-group transactions. Therefore, transfer pricing regulations have become imperative for those countries that do not have any regulations in this area, and updates on existing laws have also become necessary. As a matter of fact, the subject of transfer pricing is known to be very sensitive on the international political stage.

A transfer price is a price used to value transactions of goods or services between affiliated enterprises. In some cases, these property transfers can lead to the following two extremes: double taxation, or, contrariwise, decrease of the amount of taxes paid to a country.

According to article 7 of the Romanian Fiscal Code, two persons (either natural or legal) are affiliated if their relationship can be defined by at least one of the cases stated below:

a) A natural person is affiliated with another natural person if they are husband and wife or maximum third degree relatives. The price at which goods or services are transferred between affiliated persons is known as “transfer price”;

b) A natural person is affiliated with a legal person if the natural person owns, directly or indirectly, including the holdings of the affiliated persons, minimum 25% of the value of shares or voting rights in the legal person/entity or if it effectively controls that other person;

c) A legal person is affiliated with another legal person if:
   (i) The first legal person owns, directly or indirectly, including the holdings of the affiliated persons, minimum 25% of the value of shares or voting rights in the second legal person/entity or if it effectively controls the second legal person;
   (ii) The second legal person owns, directly or indirectly, including the holdings of the affiliated persons, minimum 25% of the value of shares or voting rights in the first legal person/entity or if it effectively controls the first legal person;
   (iii) A third legal person owns, directly or indirectly, including the holdings of the affiliated persons, minimum 25% of the value of shares or voting rights in both the first and the second legal person.

Specialists in the field of transfer pricing numerate three main categories of transfer prices, according to the way they are assessed, in the following manner:

a) market-based transfer prices;

b) cost-based transfer prices;
possibility to use any of the methods described in OECD’s “Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations”, but also mentions the traditional transaction methods written above as guidance [11].

Negotiated prices appear from discussions between two affiliated persons – a company who sells, and another company who buys. Among the three methods of determining transfer prices, the market-based one is considered to be optimal, because it is in accordance to the “Arm’s length principle”, and transgressing this principle may affect the tax burden intra-group.

When market conditions are used as a guiding mark, the determination of transfer prices is made in general terms. Therefore, the transaction’s value must be similar or at least comparable with the one used in a transaction between unaffiliated persons. In practical terms, according to the “Arm’s length” principle, the transfer price used in a transaction between two companies belonging to the same group must be the same as the one that would be used if the transaction would take place outside the group.

The methodology used in transfer pricing determinations consists in methods for calculating a price considered to comply with the “Arm’s length” principle and also for calculating the marginal gain of a transaction or of the entire company. Implementing these methods is necessary in order to ensure the using of the principle mentioned above.

In their “Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations” [15], OECD numbers the following methods for determining transfer prices:

a) Traditional transaction methods:
   (i) The comparable uncontrolled price method;
   (ii) The resale price method;
   (iii) The cost plus method;

b) Transactional profit methods:
   (i) The transactional net margin method;
   (ii) The transactional profit split method.

Related to these methods, the Romanian Fiscal Code stipulates (in the eleventh article) the tax-payer’s possibility to use any of the methods described in OECD’s “Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations”, but also mentions the traditional transaction methods written above as guidance [11].

In order to determinate the transfer prices, the Romanian Procedural Fiscal Code stipulates (in the 79th article) the obligation for those contributors who make transactions with related entities to draw up a record of transfer prices and to forward it to the tax administrations (at their request). (Reference no. 12 from bibliography)

In Romania, the Tax Authority entitled to request a contributor to elaborate a transfer prices record is The National Agency for Fiscal Administration (Agenția Națională de Administrare Fiscală).

In the request sent by The National Agency for Fiscal Administration, the tax-payer is informed that he will be subjected to an external fiscal audit regarding the correct determination of transfer prices and their registration in the company’s accounting books.

When receiving the request to elaborate and submit the transfer pricing record, the contributor can find himself in one of two situations. In the first situation, the company has an advance pricing arrangement (Reference no. 14 from bibliography), an administrative document issued by The National Agency for Fiscal Administration, in response to a tax-payer’s request regarding the appraisal of the conditions and proceedings in which the contributor will calculate the transfer prices (during a fixed period of time) of intra-group transactions. If the tax-payer finds himself in this situation, he no longer has the obligation to elaborate and submit the transfer pricing record.

In the second situation, an advance pricing arrangement hasn’t been issued, therefore, the contributor has to comply with The National Agency for Fiscal Administration’s request of elaborating and submitting a transfer pricing record [13].

According to article no. 1 from the first appendix in The National Agency for Fiscal Administration’s President Order number 222 from 02.08.2008 (regarding the contents of the transfer pricing records, published in Romania’s Official Monitor, Part 1, number 129 from 02.19.2008), the transfer pricing record must contain: [13].

A. Information about the group:
   a) The organizational structure of the group, both legal and operational, including interests, history and financial data on it;
   b) The general description of the group activity, business strategy, including changes in business strategy, from the previous fiscal year;
   c) Description and implementation of the transfer pricing methodology within the group, if applicable;
   d) Overview of transactions between related parties, from the European Union;
      (i) The manner in which the transaction was made;
      (ii) The billing method;
The concept of transfer pricing is more and more present lately in business and tax branches, mainly because of the intensification of multinational companies’ internalization process. This internalization process is actually responsible for the speeding up the globalization process.

The continuous growth in the volume and complexity of transactions recorded between two companies belonging to the same group enhances the increased attention that must be paid to the regime of transfer pricing. As a matter of fact, in the context of the on-going financial and economic global crisis, multinational companies’ interest in tax optimization is rising every day. This direction didn’t go unnoticed by the states’ governments, which now put much effort in controlling the field on transfer pricing, by issuing new, stricter regulations.

Moreover, the tax authorities have the right not to take into consideration transactions with non-economical goals, but also to restore the form of a transaction to reflect its economic character. There are two situations (Reference no. 9 from bibliography) in which tax authorities can ignore the economic substance of the transaction coincides with its form, but the conditions set by the related parties are different from those that would be established between unaffiliated persons.

The economic substance of the transaction is different from its form;

The economic substance of the transaction is different from its form;
Multinationals companies (MNC) are now taking steps in assuring that they have an intra-group transfer pricing policy which is both up to date and coherent. Therefore, an effort is made to adjust one’s policy so as to be in correlation with the regulations existing in the states where these companies have branch offices.

In Romania, the directions in transfer pricing high-lightens a grown concern on behalf of the National Agency for Fiscal Administration (Agenţia Naţională de Administrare Fiscală) – the tax authority which handles transfer pricing issues in our country. Consequently, multinational companies which make intra-group transfers now pay more attention to the way they make out their transfer pricing report, but also in the method they choose to determine the value of the transfer price.

During the last decade, a lot of amendments have been made to the Romanian legislation (by either issuing new regulatory documents, or by up-dating the ones already existing). Therefore, concerning transfer pricing regulations, we can enumerate [15];

a) The introduction of the requirement to comply with transfer pricing principles (for example, with the “Arm’s length” principle) – January, 2004;

b) The elaboration and introduction (May, 2007) of a procedure available to contributors, which they can follow in order to obtain an advance price agreement (APA) issued by the National Agency for Fiscal Administration; this procedure, which brings under regulation the individual fiscal solution (“soluția fiscală individuală”) and the advance price agreement was adopted through the Government’s Decision number 529 from 2007, and was published in Romania’s Official Monitor, Part 1, number 395, from 07.12.2007;

c) The introduction of the obligation to comply with submitting the transfer pricing record, elaborated by the tax-payers, at the tax authority’s request;

d) The accomplishment of a better standardization of the transfer pricing record’s content (February 2008), through the National Agency for Fiscal Administration’s President Order number 222 from 02.08.2008 (regarding the contents of the transfer pricing records, published in Romania’s Official Monitor, Part 1, number 129 from 02.19.2008);

e) The elaboration and introduction of a procedure regarding the evaluation of the value transfer prices have, published in appendix number 3 of the National Agency for Fiscal Administration’s President Order number 222 from 02.08.2008.

Currently, the UE member states seek harmonization of tax legislation, with the aim of creating a common tax base. An important effect of the common base would be giving up the requirement for compiling a transfer price record, because the realization of income in a member state shall be associated with expenses in the state where the affiliate is located.

In Romania, the guidelines on transfer pricing developed by the OECD have been assimilated into the domestic tax regulations (although our country is not yet a member of OECD), in order to harmonize these regulations in the Community.

The main effect globalization has on transfer prices is increasing their complexity, as, in fact, economic globalization is reason for the existence of transfer pricing. With the increasing complexity of this area, states are forced either to improve legislation, or to create it, in order to ensure the growth of states income taxes. Thus, increasing the number of countries with transfer pricing tax laws, leads to the establishment of a state of competition between the tax authorities in those countries to obtain a part of the profits of multinational companies. In this context, we can canvas on both positive effects (example: increasing the sophistication of the tax authorities) and negative ones (example: the increased risk of double taxation on multinational enterprises).

According to a study (Reference no. 13 from bibliography) conducted in 2006 (“Global Transfer Pricing Trends, Practice and Analysis” - Ernst & Young), the managers of multinational companies now become more aware of the importance of transfer pricing devote increasingly more resources to understanding, planning and documentation on how prices are established internally.

However, if companies fail to comply to transfer pricing regulations, the assumption of an increased risk of recalculation of taxes owed to the state can be made, in case of a tax investigation. If until recently, companies indulged in penalty payments for the use of an incorrect transfer price, today those amounts become increasingly higher, thus requiring a considerable financial effort for the companies. In these circumstances, multinationals are beginning to reassess the situation of transfer pricing, for as to minimize the possibility of a recalculation made by the authorities, if they don’t use the “Arm’s length” principle. This principle is, in fact, an international standard developed by the OECD, which implies that the value of transactions between corporate affiliates should be equivalent to that of a transaction carried out between two legal entities that are not part of the same group (independent entities) [15].

In Romania, the “Arm’s length” principle was introduced in regulations in 1994 [16].

The results of studies carried out periodically by two of the largest global consultancy companies – providing tax, audit, taxes, insurance professional advice [14 and 15] on transfer pricing, may indicate trends and manifestations in the area mentioned. Therefore, we can highlight:

a) Increased exchange of information between countries where corporate affiliates are located;
b) The simultaneous performance of audits by two states in which subsidiaries of the same company exist, subsidiaries between which transactions of tangible and intangible goods, transactions of services, or financial transaction take place;

c) Specialized departments responsible with transfer prices will be formed within multinational enterprises, so as a company’s transfer pricing’s policy can be enhanced, and also can more easily be put in harmony with national regulations;

d) The focusing of states on those areas with high growth potential of collected taxes (companies operating in such areas are currently trying to “evade” the payment of real contributions to the state);

e) The increase in the number of transfer pricing disputes; this increase occurs due to the actual importance given to transfer pricing in the context of the global economic crisis;

f) The training of specialists in the field of transfer pricing, especially in litigation on transfer pricing (specialists are needed both within companies and tax authorities); the logic of increasing the number of specialists is considering the attention paid to transfer pricing problems and to elaborating the transfer pricing record;

g) The increasing number of companies conducting internal audits on transfer pricing; these internal audits are intended to decrease the possibility of companies being put in the situation of a recalculation of the transfer prices, recalculation made by the tax authorities, during a tax control;

h) The focus of attention paid by the tax authorities to financial transactions, intangible goods transactions and service transactions made between affiliated legal persons; until recently, tangible goods transactions were more often subjected to tax investigations, and now, the control authorities are trying to create a balance between the types of investigated transactions during tax inspections;

i) The focus of attention paid by the governments on maximizing state revenues, by optimizing state taxes, so as to reduce the tendency of multinationals to develop activities on other markets, or to practice transfer prices that do not meet the “Arm’s length” principle; because of the crisis persisting worldwide, countries are trying to find sources that can increase state revenues, sources which were previously neglected – in this situations stands, among others, transfer pricing and the methods used to determine them.

Generally speaking, other global directions in transfer pricing could be:

a) New regulations in the field (in states where there is currently no legislation in force on transfer pricing);

b) The change of the documentation requirements for compiling a transfer prices record – the requirements are becoming increasingly complex and numerous;

c) The updating of the legislation (in states where it already exists);

d) The introductions of the “Arm’s length” principle in countries where it is not already in use;

e) The introduction of advance price agreements in some countries’ legislation.

If we consider the trend mentioned above, “The focus of attention paid by the tax authorities to financial transactions, intangible goods transactions and service transactions made between affiliated legal persons”, we can specify that in our country there are rules that help the application of methods for determining transfer prices and the comparisons made between the factors taken into account by the tax payer, when making transactions of the type listed above. [16].

Hereby, related to transactions involving the provision of a service, the legislator specifies using the comparable uncontrolled price method, by taking into account the fees charged by independent organizations for that service. If that method cannot be used (it may not be available in some cases), the regulations in force suggest the cost plus method.

When referring to loans between affiliated parties, the “Arm’s length” principle is used for determining the value of interest that would have been charged if the loan was contracted from a company outside the group.

In Romania, we can mention as a transfer pricing trend the use of ORBIS database by the National Agency of Fiscal Administration. This database contains public information about companies all over the world. The information obtained through this program is then used in tax audit, in order to determine whether transfer prices charged by a particular tax-payer are in correspondence with the “Arm’s length” principle (the prices should be market-based, not cost-based, nor negotiated ones).

ORBIS provides an overview of the organization of multinational companies, using information in form of reports. These reports are detailed and standardized so as to facilitate the search and analysis of the verified company.

In this database there is information on more than 60 million companies around the world, information that can be queried using predefined criteria. Among the selection criteria, we enumerate: the location criteria, the NACE code, the degree of independence (for example, 25% direct or indirect control), the turnover, the number of employees, financial data, the operating results, intangible assets in total assets, the qualitative analysis criteria. This last criterion is a manual one, and requires the removal of a representative sample of companies that do not fulfill the same functions or do not bear the same risks as the considered company. After the extraction of similar companies to the one we are analyzing, we choose the best method for determining the transfer prices, from the five listed in OECD guidelines: traditional transaction methods – the comparable uncontrolled price method, the resale price method, the cost plus method; and transactional profit methods – the transactional net margin method, the transactional profit split method.

Currently, ORBIS is presented into two versions: a DVD version, and an Internet one.
CONCLUSIONS

In these conditions, the study of transfer pricing is of particular importance, firstly because it is designed to equally distribute the taxable weight between the countries that “host” the subsidiaries of multinational companies; and secondly because it offers the same competitive conditions both to independent enterprises, and to affiliated ones.

In the current global economic context, the state tax authorities show a strong interest on how to determine transfer prices, and on the equity of the determinations, in order to prevent profit transfer of a multinational company from a state with high tax levels, to another state, with a more relaxed fiscal policy.

It is important for the tax authorities of different states to have a good cooperation for streamlining the information between countries, but also to avoid situations where disputes arise between countries on the transfer price considered fair and avoid double taxation.

However, a high importance in terms of transfer pricing and their trends is represented by the realization that transfer prices are more likely to generate fiscal risk, rather than to be the source of tax optimization.

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