

## THE USELESS OF THE TRANSFER PRICING FILE

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### **Abstract**

*In the context of the globalization and of the strengthening of the relations between the UE economical agents, it appears more and more the idea of groups of entities for the justification of the reciprocal deliveries, buying and loans. The transferring price is a concept that requires maximum attention from the affiliated parts, meaning the entities with reciprocal operations and common managers or associates. The theme of our study is the verification of the hypothesis when the transferring price documentary file is not useful. The research methodology of our study include: dedicated literature, study cases, etc. the conclusion is that all affiliated entities (according to the national legislation) are legally imposed to establish such a documentary file and the tax authorities may require explanations and information related to the content of this file. Still, the file does not bring extra information for the tax authorities, because its establishing is partial from the start, because no tax payer will accuse himself in front of the tax authorities. We propose the elimination of this documentary file and its replacement with an electronic format of information to an international level, so the tax authority can perform an analysis of the intra-group operation without going to the premises of the economical operators*

**Key words:** prices, availabilities, profit, affiliated person, intra-Community operations.

**Classification JEL:** M40, M41

### **1. Introduction**

Internalization, globalization and universalism are fashionable words nowadays. Without a doubt, the intra-Community exchanges and the exchanges with the third party will increase. The immense volume of exchange generates implicitly incomes, expenses, monetary availabilities for the economic operators. The present tendency is represented by the affiliated persons, groups of entities, because they can be controlled by various individuals or legal persons. The tax authorities from all the EU countries, and not only, worry about the audit manner for the legalities of the intra-group operations. For keeping under surveillance this process of transferring profits, money and goods inside and outside the groups of entities, it was introduced as legal provision the obligation of establishing a transfer pricing documentary file. We launch the hypothesis when the transfer pricing documentary file is not justified as document emitted by the affiliated entities (Romanian or foreign legal person).

We intend to present a series of proposals for the replacement of the physical aspect of the transfer pricing documentary file for a better management by the national tax authorities of the trade relations between the affiliated entities. The replacement of the transfer pricing documentary file will contribute to a better management of the intra-group operations by the Romanian and foreign tax authorities.

### **2. Research methodology**

The present study uses several methods and techniques, as follows:

- The method of the case study, using the presentation of tables and practical information for the validation of our hypothesis, the futility of the transferring price documentary file;
- The graphic method, using tables and graphical representation for the systematization of some information describing the notion of affiliation. This is required for the research of the potential affiliation relations: the common management of two or more entities, and the association

between the individuals and the foreign legal persons. In our opinion in practice, the associations including a foreign legal person require the most careful attention from the tax authorities in order to diminish or prevent the money transfer abroad.

A series of specific norms were also studied, as: The Fiscal Code, The Order of the National Agency for Fiscal Administration (ANAF) no. 442/ 2016 on the quantum of transactions, the terms for the establishment, content and the solicitation conditions for the transferring price documentary file and the procedure for the adjustment/ estimation of the transferring prices[2]. We underline the fact that, to an international level there is the EU Directive – BEPS (“Base erosion and profit shifting”) related to the implementation of the relations and the coordination of the recommendations from in the European countries. [5]

### 3. Theoretical aspects related to the affiliated entity

We start our presentation with some theoretical aspects related to the notion of price. The dedicated literature presents several definition of the concept.

Generally accepted, the price represents a sum of money.

The price is an economical category representing the monetary value of merchandise; a sum of money paid by the buyer for the acquisition of a product or service [3].

Some opinions consider that the notion of price is equal to the notion of cost. For the picture to be complete, we also mention the syntagma used often in the economical language: cost price, selling price, market price, just value, historic cost, etc.

We do not intend an exhaustive approach of all the notions mentioned above, due to the editorial features of our study, but we will present some important aspect for positioning the notion of “price” in the “conceptual puzzle”.

Any entity, disregarding its field of activity, organises internal economical processes, generating products, services, etc. Their selling is made to a correct value, generally called “price”. The fiscal and accountability provisions present the notion of “market price” or “market value”. It is a sure thing that the price must be calculated based on the production cost, which means that it is controlled by the management of the producing entity.

The notion of control has many meanings. According to the dictionary, control means:

- A permanent or periodical analysis of an activity, situation, etc., in order to observe its evolution and to try to enhance it;
- Continuous (moral or material) surveillance; authority, domination;
- Institution or group of individuals supervising certain activities [4].

An investor, disregarding the nature of his participation to an entity (the entity he invested in), must establish if it is a parent entity, by evaluating its control on the entity in which it was invested [6].

Thus, an investor controls the entity he invested in only if the investor meets all the following conditions:

- Authority on the entity he invested in;
- Exposal or legal right to variable incomes based on his participation (see 15 and 16 from IFRS 10); and
- The capacity to use his authority on the entity he invested in, in order to influence the value of the investor’s incomes.

Concretely, an investor controls an entity if he detains more than 50% from the shares or the social parts of an economic operator. There is also the possibility when two entities have a common manager and the two economic operators are controlled by an individual. There are many cases in practice when a foreign legal entity possesses shares or social parts in several entities and performs reciprocal operations between all the members of the group, making difficult the verification of the money transfers by the tax authorities. In our opinion, it requires many years of expertise in the

financial – accountability field in order to be able to trace the illegal transfers of money and this is rarely a feature of the verification personnel in Romania.

#### 4. The transfer of money abroad

The documents solicited by the financial inspection authorities for the VAT refund for an entity with affiliated parts are:

- An affidavit from the manager;
- The acquisition documentary file from the affiliated part;
- The selling documentary file from the affiliated part;

#### AFFIDAVIT

The undersigned, Popescu Ion, manager of SC Alfa SRL situated in Alba Iulia, Cloșca Street 19, Alba County, tax code RO 1111111, declare that during the month of May, the year N, the society I manage was “affiliated part” as defined by article 7/26 from the Law 227/2015 [1], together with its latest modifications and completions, for the following providers/ clients:

**Table no. 1 - Affiliated partners**

Society	Quality				The description of the affiliation relation
	provider		client		
	internal	external	internal	external	
Beta GES.M.B.H		x			Provider of goods and services in quantum of 2.685.293 lei
Beta GES.M.B.H				x	Client for goods in quantum of 4.650.193 lei

The present affidavit was written to the solicitation of the fiscal inspection authorities.

Date,  
03.08.N

Signature,

In our opinion, the fiscal inspection authorities should not solicit such an affidavit from the tax contributor, because the contributor may refuse it, proving the weak professional training of the employees in the services of fiscal administration. The fiscal inspection authorities should establish before visiting the society its affiliation, studying especially the certificates emitted by the Registry of Commerce, all available online.

Thus, the study of the certificates may give information related to:

- If two entities have common managers, meaning a significant control and the need for the fiscal authority to solicit the transferring price documentary file;

- The existence of common share-holders for two or more entities (individuals or legal entities, Romanian or foreign). A special attention must be paid to the share-holder represented by a foreign legal entity. In this case, the form 390 “Declaration on intra-Community furnishings/ acquisitions/ services”. Thus, it is possible to observe if there are operations with the foreign partner (selling, buying, services, etc.) A fragment from the Form 390 is presented below.

Form 390 “Declaration on intra-Community furnishings/ acquisitions/ services” for Alfa SRL:

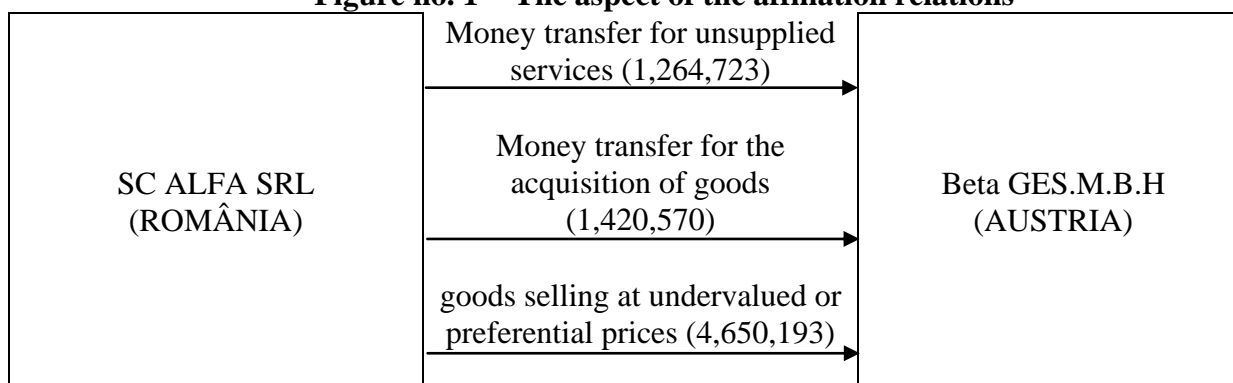
**Table no. 2 - Fragment from Form 390**

No.	Type*	Country	Intra-Community operator code	Naming/Name, Surname intra-Community operator	Calculation basis
1	A	Austria	U123456	Beta GES.M.B.H	1.420.570
2	S	Austria	U123456	Beta GES.M.B.H	1.264.723
3	L	Austria	U123456	Beta GES.M.B.H	4.650.193

\* L – intra-Community furnishing, T – furnishing in a triangular operation, A – intra-Community acquisition, P – intra-Community services supply, S – intra-Community services acquisition.

A look at the table above shows that the intra-Community furnishings are declared to be 4,650.193 lei (SC Alfa SRL sells to the Austrian partner) and the acquisitions from the external partner are of 2.685.293 lei. It is tempting to consider that SC Alfa SRL meets its aim, because the external selling is bigger than the external buying. But, in fact, the following operations take place:

**Figure no. 1 - The aspect of the affiliation relations**



The contemporary language speaks of abroad profit transfer. The hypothesis is false because the facts are much more serious in Romania. There is no profit transferring, it is money transfer (the two aspects should not be confused, because, for the economic operators using the double-entry bookkeeping, there is a difference between the invoice date and the collection date):

- Payments for services for the external partner in quantum of 1,264,723 lei, services that are not paid in reality, but they are documented;

- Payments for the acquisition of goods from the external partner (in reality, these goods resent quality faults or are supra-valued);

- Selling of final products, semi-products or goods at the price “imposed” by the external partner (due to its quality of affiliated part and its control in the management of). These goods leaving Romania also have a production cost (in reality, it is bigger than the selling cost, meaning 5,920,656 lei). This production cost is formed from the cost of the materials (bought from Romania), the cost of the workers (employees with contracts) and other costs.

SC Alfa SRL is in the paradoxical situation of having a big selling in that specific accountability period, but, comparing it with the production costs, it results that the enterprise registers fiscal losses and does not pay taxes for profit. Moreover, for the materials necessary to the final products sold to the external partner, SC Alfa SRL will benefit of VAT reimbursement from the Romanian state.

As synthesis for the above aspects, we conclude:

- There are affiliation relations between the two entities;

- There is a financially advantageous relation for the external partner and just the opposite for the Romanian partner, also for the state of Romania;

- The fiscal inspection authorities have no possibility to sanction the economical partner from Romania or to impose restrictions to the furnishings with preferential prices for the external partner (although there is the possibility to solicit the transferring price documentary file). The transferring price documentary file (completed by the contributor or a third party) only delays the responsibility of the financial contributors and permits the continuation of the availabilities transfers;

- In practice, the transferring price documentary file presented to the authorities may be (most of the time is) ignored and estimations are calculated. The estimations may be contested in juridical actions, bringing: litigations, expenses and wasted time, all in the detriment of correct and profitable business, etc.;

- The transferring price documentary file is completed using several data bases with various prices, different from the one used by the tax authorities, leading to many opinion divergences.

For stopping the money transfer abroad, we propose:

- The elimination of the transferring price documentary file, because: the contributor will no longer pay for its completion; the invocation of different prices is also eliminated; the potential long litigations are also excluded;

- An attentive verification of CMR and of the external invoices by the fiscal inspection authorities in order to observe the possible lack of concordance related to the quantities of goods;

- The legal prohibition of direct selling of goods and services to the foreign partners which are affiliated parts (this will lead to the avoidance of imposing advantageous prices for the foreign affiliated parts).

The futility of the transferring price documentary file is also generated by the fact that the fiscal inspection authorities and not the fiscal contributor must prove the preferential price selling/buying. It is normal for the one completing the transferring price documentary file to be partial and present an advantageous situation, sometimes “fixed” for presenting it to the authorities.

Moreover, there are no noticeable results in practice for the fiscal authorities related to the depiction of supplementary calculation bases based on the transferring prices documentary file. Another argument for the futility of this file is the fact that some economical operators prefer not to complete it and instead pay a fine of 12,000 lei, which is a sum much inferior to the costs of completing the document.

We present below the centralisation of the acquisition documents for a specific period of time:

**Table no. 3 - Acquisitions from Beta GES.M.B.H**

No. doc.	Date	Provider	Value
DOC 9	04.05.N	BETA SRL	1,721,420.82
DOC 10	09.05.N	BETA SRL	61,542.79
DOC 11	16.05.N	BETA SRL	129,480.30
DOC 12	24.05.N	BETA SRL	251,473.19
DOC 13	31.05.N	BETA SRL	521,375.90
Total			2,685,293.00

The table above shows that SC Alfa SRL performed acquisitions from Beta GES.M.B.H in quantum of 2,685,293.00 lei. After a summary analysis of the table, the problem of the payments in advance also appears. In practice, the invoices in advance between the affiliated parts are completed due to:

- Temporary necessities of cash (payments for suppliers, salaries, state, etc.);

- VAT payments much lower as quantum (for the Romanian legal entities);
- VAT reimbursement.

In Romania, the fiscal inspection authorities concentrate especially on the verification of the invoices, trying to observe as much not-reimbursement sums as possible (“sometimes abusively”, our opinion). We think that the fiscal inspection authorities should also orient to the depiction of availabilities to the third parties.

We present as follows a centralising situation with the selling values to an affiliated part:

**Table no. 4 - Furnishings to Beta GES.M.B.H**

No. doc.	Date	Client	Value
DOC 72	09.05.N	BETA SRL	2.462.341,05
DOC 80	11.05.N	BETA SRL	52,236.19
DOC 86	22.05.N	BETA SRL	68,971.68
DOC 93	27.05.N	BETA SRL	96,378.21
DOC 101	28.05.N	BETA SRL	1,970,265.87
Total			4,650,193.00

We mention that the centralising situation reflects the volume of selling to the affiliated part. This volume presents in our opinion no sign of breaking the law for VAT for the profit taxes if the invoices reflect a real selling of goods and services .

Our recommendation for the inspection authorities is the following procedure:

- To solicit the compenence of the stocks of merchandise, final products, semi-products, consumables, etc.
- To observe the selling of goods that is preponderant for a specific period of time;
- To establish for each product the acquisition or/ and the production cost. Thus, it may be performed a comparison between the historical price and the selling price per product and adjustments for the VAT reimbursement and the taxes for profit may be made by the fiscal authorities.

Another important aspect is represented by the correct establishment of the production cost. This is a sensitive point for entities, but it is an aspect that represents the starting point for establishing the supplementary bases for the profit taxes or the VAT tax.

## 5. Conclusions

The transferring prices should be a national and international priority, because, by various practices, some countries (with resources but no political influence) transfer money to the countries with a strong political influence and which are decisional factors in UE.

We recommend to the National Institute for Statistics to solicit a series of information related to the intra-group prices in the detriment of the present solicitation (many of them are futile and with no informational power: statistics on the industrial products, the working force, etc.). These solicitations should be completed as data base, where each contributor should have a user name and a password and complete pre-definite fields as: the name of the product/ service inside the group; the medium selling price; the unitary price for the top three sold goods, the material costs per piece. Thus, it could be completed an electronic data base, where the fiscal authorities can verify easily some essential information in their offices, on computers.

Also, to the Intrastat level, it should be completed an integrated data base with reports on the information presented above from all the affiliated parts (parent society and branches). A crossed verification will be possible following the reports.

We propose the elimination of the transferring prices documentary file on paper due to the following aspects:

- The contributor will no longer pay the value of its completion;
- It is eliminated the invocation of various prices by the contributor and the fiscal authorities;
- There are excluded the possible long-term litigations.

A last proposition is more daring because our proposition is the legal prohibition of selling between the affiliated parts (only related to goods and services). We do not propose a restriction of the loans between affiliated parts, because any economical operator may be in a difficult situation and need cash for paying fiscal, commercial or other type of obligations.

## **6. The limitations and the perspectives of the research**

Any research presents limitations. The limitations of our research are as follows:

- The lack of a national statistic related to the entities obliged to complete the transferring price documentary file (the Order 442/2016 presents a series of value thresholds);
- The absence of data related to the number of files solicited and presented to the financial inspection authorities;
- The lack of statistical data related to the agreements of payments in advance.

We aim to establish during a future research a sample of entities to be applied a questionnaire on the prices inside and outside the group.

## **7. Bibliography**

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