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MAXIMIZING PROFIT AFTER TAXATION BY EFFECTS OF TRANSFER PRICES IN MULTINATIONAL COMPANIES

МАКСИМИЗИРАЊЕ ПРОФИТА ПОСЛИЈЕ ОПОРЕЗИВАЊА ЕФЕКТИМА ТРАНСФЕРНИХ ЦИЈЕНА У МУЛТИНАЦИОНАЛНИМ КОМПАНИЈАМА

Summary: *About 70 % of today's world trade takes place between related companies. Transactions between them are called assignment or transfer, and the prices at which the group of related companies accounted value of the purchase and sale of financial results, are called transfer pricing. The main aim of this paper is to determine the impact that transfer pricing has on the creation of international tax issues. Transfer prices between related parties may substantially differ from the prices created for the same or similar transactions between unrelated individuals in a free market. Transfer prices are an important tax issue which is characterized by increasing complexity and level of commitment of tax authorities around the world on this issue.*

Keywords: *multinational corporations, transfer pricing, tax, international tax issues, „tax havens“.*

JEL Classification: *H26, M41, O16.*

Резиме: *Око 70% данашње свјетске трговине, одвија се међу повезаним предузећима. Трансакције међу њима називају се преноси или трансфери, а цијене по којима се унутар групе повезаних предузећа обрачунава вриједност набавке и продаје пословних учинака, називају се трансферне цијене. Основни циљ овог рада је да утврди утицај који трансферне цијене имају на стварање међународних пореских проблема. Трансферне цијене међу повезаним лицима могу знатно одступати од цијена које се образују за исте или сличне трансакције између неповезаних лица на слободном тржишту. Трансферне цијене су веома важно пореско питање чија је карактеристика комплексност и све већи степен ангажованости пореских органа широм свијета око овог питања.*

Кључне ријечи: *мултинационалне компаније, трансферне цијене, порез на добит, међународни порески проблеми, „порески рајеви“.*

ЈЕЛ класификација: *H26, M41, O16.*

1. INTRODUCTION

Globalisation, the rapid development of technology, transportation and means of communication are factors which require the existence of an increasing number of multinational companies, which are flexible enough to be able to establish the company and carry out their business activities anywhere in the world. The fact is that the largest part of international trade, according to the World Trade Organization - over 60% - is made of transactions (goods, services, capital and intangible assets) between the member companies of such international groups. Such transactions between member companies of multinational companies (related parties) are guided by a combination of market and policy conditions that may significantly differ from the conditions on the open market i.e. the sort of conditions that exist in business dealings between independent companies. Therefore, a

growing part of such international transactions is no longer under the influence of market forces, but under the strong influence of common interests of member companies of such international groups.

The reasons for the existence of such transactions may be different, ranging from business strategy to tax reasons. In the light of commercial and strategic reasons, multinationals may intend to use the mechanisms of inter-corporate transactions to reallocate income or expenses that are unevenly distributed by individual member companies. In this way, they increase the efficiency of the whole group, i.e. they relieve those parts of the companies who bear most costs versus those parts that have the highest rate of return.

On the other hand, using this mechanism, the profit can be located in member companies that are based in jurisdictions with the lowest effective tax rates and thus maximize business profits at the level of the entire multinational company. For example, a multinational company based in Cyprus, with a subsidiary in Bosnia and Herzegovina, which specializes in manufacturing computers, buys processors, the products of the company from Bosnia and Herzegovina at a price that is slightly lower than on the normal market. Finished computers in Cyprus are sold at full price, and the company reduces the cost of manufacture of the product and thus increases the profit that is less taxed in Cyprus, while companies in Bosnia and Herzegovina have very little to no profit, for which it pays income tax at a higher rate than in Cyprus. At the group level, the total profit from these transactions is increased, because, on the one hand, part for the final product was purchased at a lower price, and on the other hand, a tax burden at the group level is much lower.

2. HYPOTHESES, METHODOLOGY AND EMPIRICAL DATA

In accordance with the above, the subject of this paper is transfer pricing as a factor of business of multinational companies. In the first part of the paper, the transfer pricing will be discussed in general, followed by the types and methods of their determination. The second part of the paper is dealing in more details with the impact that transfer pricing has on taxes.

Accordingly, the main hypothesis (H1) states: Transfer prices significantly affect the creation of international tax issues.

Research hypothesis was tested by applying the appropriate methodology and after analysis of all collected data, it is positively confirmed.

The primary research methodology of the treated problem through a given research hypothesis is: the literature-based research of various aspects of the impacts that transfer pricing has on the creation of international tax issues.

3. METHODOLOGY OF TRANSFER PRICING

The concept of transfer pricing in the accounting literature has been present for a long time. It appeared with a decentralization of complex organizational structures of businesses. The transfer pricing received a special role with development of business combinations. Transactions of acquisitions of businesses formed a large group whose organization consists of a parent entity and dependent entities. Base entities are entities that are in position to control dependent entities because they have more than 50% of the voting rights. Dependent entities are entities that are controlled, and can be either in the country of the parent entity or in the other countries. In recent times, transfer pricing particularly has significant role in complex holding companies at international level. Due to the trade between the parent company and subsidiary entities located in different countries the tax implications of transfer pricing have increasingly been expressed.

At the level of a decentralized entity, transfer prices are prices at which one organizational unit charges the other for delivered parts, assemblies, products or services on which other organizational unit continues production or sells them on the external market. At the level of a complex decentralized entity these transfer prices are also known as internal prices.

When it is about the group at the international level, the transfer of goods and services between the parent company and subsidiary entities shall be at transfer prices.

For example, in the case that the parent company produces equipment, and a subsidiary installs that equipment in another country, transfer pricing can affect the level of income and the

income tax of the parent and subsidiary entities. Established transfer pricing of equipment affects in this case the cost of the subsidiary entities and at the same time the income of the parent. This means that, no matter how transfer prices are formed, they can significantly affect the profitability of each entity within the complex group. This is also true at the level of a decentralized entity.

The price at which a manufacturing plant supplied parts or assemblies to another one, directly affects the expenditure of manufacturing plant that takes parts, and the revenue of the other which supplied parts.

In any case, the transfer prices affect business decision-making process on the input and output. These decisions directly affect the profit, rate of return on investment as well as the taxation of income when it comes to complex organizations at the international level (Denčić-Mihajlov and Trajčevski 2011, 397-414).

According to the Law on Corporate Income Tax of the Republic of Srpska, the transfer price is the cost incurred in connection with transactions of assets, or creating of obligations between related parties.

In these transactions, the Tax Administration of the Republic of Srpska increases or decreases the amount of income or expense if it determines that the transfer price does not reflect the market price and the method of determining the market value of the transaction shall be governed by the Regulations.

4. THE EFFECTS OF TRANSFER PRICING ON BUSINESS PROFITABILITY

The purpose of transfer pricing can be seen depending on:

- whether it is a single entity that has a decentralized organizational structure or
- the group consisting of the parent entity and dependent entities at national or multinational level.

In the first case, the transfer pricing is the instrument of optimization of the success of individual organizational units, and thus the success of the whole company. In fact, although the activities within a subject are not related with market, operating profit of one manufacturing plant (profit center or an investment center) can be a significant motive or initiator for the management and employees of that unit. Transfer pricing in these subjects should be an initiator of cost reductions in the supply chain at the level of a single business entity. Supply chain within a single entity has a direct impact on the final price of a product or service. The costs of individual parts of the organization, which make the supply chain, should be controlled. This applies especially to the typical cost centers and support centers whose costs should be allocated to the profit and investment centers. When company management favors a high degree of decentralization of organizational units then transfer prices promote a high degree of autonomy. That means, if the manager of a facility (e.g. profit center) seeks to maximize the operating profit of his facility, he should then have freedom to negotiate with other departments within the company on input prices and output prices (Adams and Drtina 2008, 411-417). In particular, the manager of a facility, which is also a profit center, should have the freedom to choose the procurement of parts, assemblies, or some of the services from:

- other facilities or departments within the company or
- other entities outside the organizational structure of the company.

In the same way, the manager of a facility that is also a profit center should have the freedom to sell their products (parts or assemblies) and service to other departments within the organizational structure of the company or other entities outside the company.

Figure 1 Effect of transfer pricing

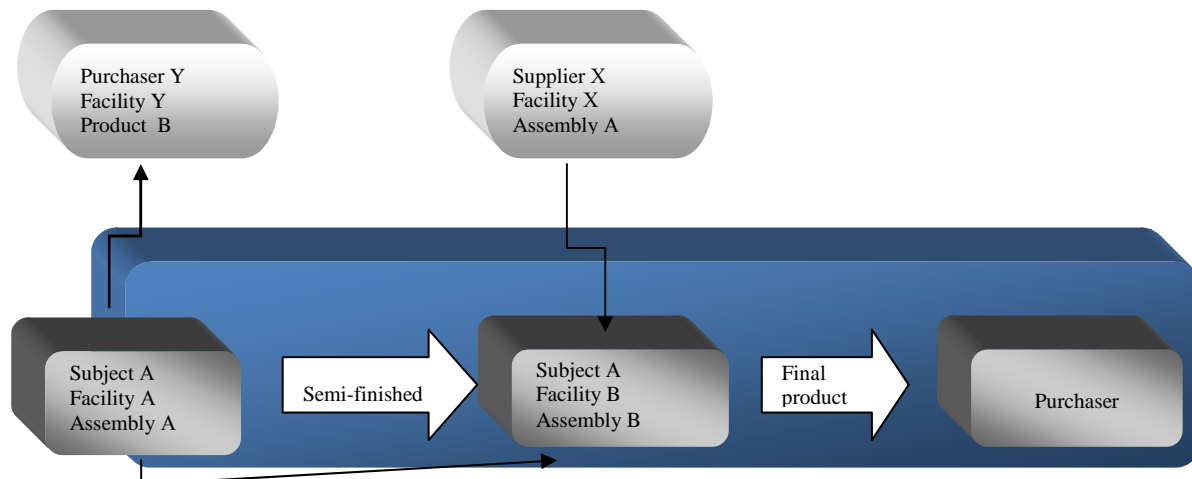


Figure 1 shows how this freedom of choice or decision on transfer prices can affect the supply chain.

Manager of subject A, facility B has two alternatives:

- purchase assembly A from his facility A or
- purchase assembly A from an external entity X.

At the same time, the manager of the entity A, facility A has two alternatives:

- sell the assembly A (semi-finished) to purchaser – facility B within the company, or
- to sell the assembly A (semi-finished) to purchaser Y, customer outside the company, which also produces the same or similar products as well as subject A.

Transfer prices at the level of a multinational group (holding) which consists of a parent and subsidiary entities, have multiple effects. They directly affect business performance of group members in the supply chain. The result are different levels of corporate taxation and the taxation of distributed profit of group members in different countries. Transfer pricing is used to transfer profit from countries with high tax rates into countries with lower tax rates. It has direct affect on increase of profits in countries with lower income tax rates. On the other hand, transfer prices can have a controlling role (Horngren et al. 2003, 759). Thus, for example, if the parent wants to make its subsidiary pay its dividends, and this can not be due to legal restrictions, then the parent company artificially increases its profits and reduces the profits of the subsidiary entities.

5. METHODS OF DETERMINING TRANSFER PRICES

Transfer prices are used in the exchange of goods and services between the parent company and its subsidiaries, or between two dependent entities of the same company. Global companies often manipulate the total realized profits using transfer pricing, transferring it to a country where they have a subsidiary, in which the tax rate is lower than the country in which it is created. (Anthony, and Govindarajan 2007, 121). The rules for determining transfer prices in most countries are based on the principle of "arm's length" - which requires that transactions between related parties are contracted under market conditions, or the conditions under which such a transaction would have occurred between unrelated parties under the same or similar conditions. (Templar 2005, 70.)

5.1. The „arm's length“ principle

Following the example of the United States and the Organization for Economic Cooperation and Development (OECD), tax authorities around the world have introduced regulations that require from multinational companies to document the mutual transactions in accordance with the „arm's length“ principle. The member states of the OECD adopted the „arm's length“ principle for several

reasons. The main reason is that the principle provides equal tax treatment of members of the Group of multinational companies (GMNP) and unrelated persons. (Bakker 2009, 49) As the principle of "arm's length" equates the status of related and unrelated entities for tax purposes, this avoids the creation of tax benefits or unfavorable tax treatment, which could disrupt, in relative terms, the competitive position of any of the two types of entities. By removing these tax reasons of economic decisions, the principle of „arm's length" promotes the growth of international trade and investments.

It was found that the principle of „arm's length“ works effectively in the vast majority of cases. For example, there are many cases involving the purchase and sale of raw materials, as well as lending money where existing price „arm's length“ can easily be found in comparable transactions between comparable unrelated parties, under comparable circumstances. Also, there are numerous cases where the relevant transaction comparison can be done at the level of financial indicators such as price and gross margin or net profit indicators. However, there are several significant cases in which it is complicated and difficult to apply the principle of "arm's length", for example in GMNP operating in the integrated production of highly specialized goods, using unique intangible assets and/or providing specialized services. There are solutions for those complex cases, which involve the use of method of transactional profit division.

The principle of "arm's length" has a solid foundation in the theory, since it provides the closest possible estimate of the open market, in cases where the assets (such as commodities and other types of tangible and intangible assets) is transferred or the services are performed between related parties. Although it may not always be easy to apply it in practice, it generally determines the appropriate level of benefits between members of GMNP acceptable to the tax authorities. This approach reflects the economic realities of the particular facts and circumstances of the taxpayer - a related person, and as a basis for comparison of uses of common market operations.

Derogation from the principle of „arm's length“ would leave the above theoretical foundation and jeopardize international consensus, which would significantly increase the risk of double taxation. Experience in the application of this principle has become sufficiently widespread and sophisticated to establish a strong basis for mutual understanding between the business community and the tax authorities. The common understanding has great practical value in order to ensure appropriate tax base in each jurisdiction and avoid double taxation. (Bakker and Levey 2011, 29) These experiences should be used to make the „arm's length“ principle more developed, to optimize its use and improve administration, so as to create clearer guidelines for taxpayers and provide for timely performance of the control systems. All together, the OECD countries continue to uphold the „arm's length“ principle. The fact is that there has not yet appeared a legitimate or realistic alternative principle. Global distribution of profit by the formula, which is occasionally mentioned as a possible alternative, is not acceptable in theory, implementation and practice.

5.2. The traditional transaction methods

The OECD has published guidelines based on the „arm's length“ principle. There are many methods for determining transfer prices and some systems give priority to a particular price testing method, but the method used for testing the price of the related parties should be the method that produces the most reliable measure of „arm's length“. (Soo and Glaize 2014, 289)

Traditional transaction methods are:

- Method of comparable prices
- The resale price method
- The method of cost price increased for a reasonable profit

Method of comparable prices

The best immediate option for checking transfer pricing is comparison of transfer pricing established between related parties, with those charged at comparable transactions between independent enterprises. It often happens that comparable jobs do not exist. (Ernst and Young 2013, 6) It is therefore necessary to evaluate the transactions between related companies in terms of the overall range of the realized gain and thus establish whether operating conditions are comparable to transactions between independent enterprises. This way of designing and analyzing transfer pricing is typical for standard methods.

Method of comparable prices compare prices of goods, services and rights that are formed in controlled transactions between related enterprises with comparable prices in uncontrolled transactions that are formed between independent enterprises in comparable circumstances. In case of differences between the prices it may mean that the market and financial relations among related parties are not in line with those that apply to comparable transactions between independent enterprises. Therefore, the transfer price between related parties should be exchanged with prices that exist and are valid for transactions among unrelated parties.

For application of the method of comparable prices on the market, uncontrolled transaction is comparable to a controlled one if one of the following two criteria is met:

- None of the differences (if there exist any) between the transactions being compared or between the enterprises participating in these transactions, can significantly affect the price in the open market.
- Acceptable precise adjustments can be made in order to eliminate the significant effects of these differences.

When it is possible to establish a comparable uncontrolled transaction, method of comparable prices in the market is the most direct method for determining the principle of „arm's length“. Accordingly, in these cases, this method has primacy over all other methods.

Resale price method

The starting point of the resale price method is the selling price of goods and services purchased from related parties and re-sold to an unrelated company. When that selling price is deducted by the price difference (the entire profit of resale price), which includes the costs of intermediaries in accordance with the stakes, the risks taken and the appropriate part of the profits (purchase price + costs cover + sellers profit), we get the transfer price, which corresponds to an independent market principle according to which the related parties should count goods and services to each other. Profit of resale price for sellers in a controlled transaction is determined on the basis of profit of resale price which such reseller earns on the sold and purchased goods compared with uncontrolled transactions. The orientation can also be the profits of resale price earned in comparative independent transaction by independent company. This means that the basis for comparability is represented by the price that would be achieved by the related company in transactions with independent enterprises. The best results in the area of trade are achieved by using this method.

The method of cost price increased for a reasonable profit

Price determined by the method of cost price increased for a reasonable profit is the price determined on the basis of the actual total costs of production, i.e. the cost of the services, plus reasonable profit (margin), or commission. Margin or commission is earnings earned in the same or similar transactions between unrelated persons, or at about the same time.

Thus, in the method of cost price increased for a reasonable profit, the starting point is the cost of the supplier of the goods or services in a controlled transaction relating to the transfer of goods and services to the customer, a related person. Then the corresponding margin is added to these costs in order to provide adequate earnings in accordance with the functions performed and the market conditions. What is obtained after adding margins, can be considered as the price „arm's length" of the original controlled transaction. This method is probably most useful in trade of semi-finished products between related parties, where related parties have concluded agreements on joint production or a long-term contract of purchase and procurement, or when the controlled transaction is related to the provision of services.

Margin of a supplier in a controlled transaction should be established on margin achieved by the same supplier in a comparable uncontrolled transaction (internal comparability). In addition, the margin that was earned in comparable transactions by an independent enterprise may serve as a guideline (external comparability).

Methods of transactional profit

The methods that are based on the profit are used for determining transfer prices in cases where due to the complexity of business situations there are no available data, or when they are not of sufficient quality or when because of the nature of the situation, the company can not use the traditional transaction methods, or when they are not reliable enough. They obtain the appropriate transfer prices based on the size of the profit realized in a transaction between related parties.

Methods of transactional profit test profits arising as a result of certain controlled transactions. Methods of transactional profit are:

- method of transactional profit division and
- transactional net margin method.

Profit arising from the controlled transaction may be a relevant indicator of whether the transaction was influenced by conditions that differ from those that would be incurred by third-party companies or other comparable conditions.

Method of transactional profit division

The method of profit division will be used in cases where we are dealing with such interrelated transactions, which can not be split and processed each individually and there is no possibility of comparison. The process of determining the transfer price must be run in the following order:

- Identification of profit in controlled transactions between related enterprises;
- Division of profit among related companies in accordance with the committed functions, taken risks and invested funds, where it is necessary, approach to the division for unrelated enterprises;
- In the case when it is not possible to divide overall profit among companies at concessionary functions, since we do not know which function is most responsible for profits, we share residual income at a flat rate. Such cases refer, above all, to highly innovative products, intangible funds, and others.

Transactional net margin methods

Transactional net margin method examines the net profit compared to the corresponding basis (e.g. costs, turnover, assets) that the taxpayer made from the controlled transaction. That is why the transactional net margin method functions similarly to the method of cost price increased for a reasonable profit and the resale price method. This similarity means that for reliable application, transactional net margin method must be applied in a way that is consistent with the manner of applying the resale price method or method of cost price increased for a reasonable profit.

Transactional net margin method will be most reliable if each part in the transaction provides a valuable and unique contribution. In such a case, the method of division of transactional profit is generally the most appropriate. However, one-sided method (traditional transaction method or transactional net margin method) can be applied in cases where one of the participants in the transaction provides full and unique contribution to the controlled transaction, while others do not make any unique contribution. (Lall 1973, 173-195) In this case, less complicated participants in the controlled transaction should be tested.

There are many cases when the transaction participant contributes to the transaction, but this contribution is not unique. Participant e.g. uses intangible assets, which is not unique as a business process or knowledge of the market that has not unique character. In these cases, it is possible to provide comparability to meet the conditions for the application of the traditional transaction methods or transactional net margin method because it is expected to use in comparable transactions a mixture of comparative contributions that are not of unique character.

Finally, the absence of a valuable and unique contribution involved in a particular transaction does not automatically mean that the application of the transactional net margin is the most appropriate.

6. THE NEGATIVE TAX IMPLICATIONS OF THE TRANSFER PRICING OF MULTINATIONAL COMPANIES

Transfer pricing in multinational business systems occurs with decentralization of complex organizational structure of business entities. These are transactions between related parties of multinational corporations and they represent an important segment of business both at home and abroad. They are increasingly the subject of attention of tax administrations, because such way, of "risk reduction of business transactions" can be extremely unethical, inappropriate and even illegal. Transfer pricing receives special role in the development of so-called "business combinations". These "business combinations" are based on transactions between the parent company and subsidiary entities located in different countries with different systems and tax rates. None of this would be a problem if there were not a significant level of abuse of these transactions. In fact, this phenomenon may affect significantly the level of profit of each entity within a complex group that realizes the transaction.

Simply put, the existence of transactions with related parties abroad is completely normal trend in the business world of multinationals, but also an important "minus" item in tax revenue in many states.

Objectively observing, we become aware of the fact that business relationships among persons who have the possibility to control and influence business decisions among themselves will not always be based on purely market principles. This can have an extremely detrimental effect on tax revenues of one or more states. "Cheating" tax systems by a kind of "modifying" the price is in some sense considered as a specific skill of multinational companies. Of course, you shouldn't always look at the negative and say that every company wants the move to damage the tax revenue of the state. This phenomenon can arise from purely real motives for efficient operations (increase liquidity, capturing more favorable position in the market, the possibility of greater support from banks). However, the real motives sound unconvincing and produce a certain amount of suspicion, because in some literature the transfer prices are also called "suspicious prices".

The problem that the country that could be potentially a damaged protagonist of the whole story is faced with is an attempt to reconcile the two opposing principles. In the first place it is the goal of preserving tax revenues and the second is restraining the economic development of their own country by imposing too strict tax rates. In these situations states often come out as a loser, because the stimulation of economic development is often the first priority. If we take that this country is from the row of the countries in transition and developing countries, we find that any illegal act done by using transfer pricing as a commercial-criminal instrument can be treated as a normal segment of promoting international business cooperation and economic development.

Although strict and clearly defined legal standards (of the various states) of the tax legislation are trying to prevent any abuse of transactions between related persons of a particular corporation, there is a number of "holes" - legal flaws, and currently there is not clear solution for them. When we talk about the legal norms, it the principle of "arm's length" should be emphasized. In many tax jurisdictions there would be such a definition: „The taxpayer is obliged to indicate in its tax balance sheet separately the amount of transfer prices from related party transactions, and then to determine and express what their value would be on the open market between unrelated parties ...“ This is an attempt that taxpayer's transfer prices are included in the tax base. All this works extremely reasonable and clearly in the theoretical sense, but the practical application of the law encounters different concerns or questions: „How to determine the „arm's length“ price?“ And "How to demonstrate the effect of any difference between a taxpayer's transfer pricing and „arm's length“ prices?“. These questions give rise to a series of other issues (whether pricing is done on the basis of individual transactions between some unrelated persons, or in some other way?), which theoretically can all be clarified, but while it is made more complicated theoretically, the practice demonstrates the growing negativity shocks to the tax systems of countries in this way.

7. „TAX HEAVEN“ COUNTRIES

In today's world economic trends, great importance is given to the phenomenon of tax competition and to the numerous negative consequences that its existence may cause. The existence of harmful tax practices leads to disturbances in the functioning of national markets. The global economic and financial crisis has increased the level of "nervousness" of many countries on this issue. Specifically, in the conditions in which the global economy is, one gets the justified impression that the rich ones do not bear the brunt of the difficulties caused by the economic crisis, but they rather avoid paying taxes through the "tax havens". *The greatest economic crisis since the Great Depression has a variety of causes, and surely includes long-term existence of offshore zones that enable a myriad of financial machinations.*

"Tax havens" are one of the main features of the global economy that have developed with the liberalization of financial markets and the processes of globalization in the last three decades. This presents a huge problem, especially in developing countries. However, this can be extremely problematic for developed countries, because it allows the rich around the world to move their personal wealth to exotic islands or major financial centers to avoid paying taxes. This brings us to the core issue, i.e. to influence of the functioning of "tax havens" to multinational companies, because they are the key problem of "looting" of fiscal revenue in many countries (especially the disadvantaged and those in transition). Specifically, by funds transfer, or by transferring profits out of the country where it is earned to the countries where you do not have to pay taxes on your earnings is one of the business "dirty instruments" of MNCs. So many MNCs do not pay at all or pay negligible taxes on realized profits. This is a key structural lack of globalized financial markets. Generally speaking, if this story would not include politics, this problem would not be so often ignored. Civil society is trying to make the system pressure on politicians to adopt systematic measures to prevent this marauding activity. The European Union is trying with legally non-binding acts, to conduct a campaign aimed at combating this phenomenon, because not only Greece, but also Italy and Spain, and the United Kingdom, are faced with economic problems, including avoiding paying taxes as one of a number of reasons.

The research of the European Commission and the OECD leads to the conclusion that the measures are unfair not only for the poorer and less developed countries, but also for countries of high economic development and significant income per capita. Liberalized economy has allowed the most powerful actors in the market through transfer pricing to perform a kind of tax evasion and not be responsible for that. When the transfer pricing "fits" into a story about „tax havens“ and offshore companies, we come to the conclusion that the injured parties are not just economically weak countries like Serbia, BiH... but also some of the most powerful economies such as the UK, USA, Germany, France and so on. Essentially something has to be done on tax measures that will enable this negativity to be removed.

First, tax avoidance is to be prevented as illegal conduct. At the same time, multinational companies claim that their registration in "tax havens" or offshore zones, is legal and legitimate. However, it is highly undemocratic manner because they are trying to take advantage of legal loopholes in democratic countries. Therefore, the accounting operations of the multinational companies must be much more transparent, in order to detect questionable mechanisms used in the transfer of profits and tax evasion. However, in order to sanction the operation of transnational corporations, action by national governments is not sufficient, and there is need for more intensive international cooperation. In this way, multinational companies would be required to pay taxes on profit where it has been achieved, and not where it is reported. Now, with various accounting techniques they show huge profits in "tax havens", although it is fictitious and they do not pay almost any taxes, while the countries in which the profit is realized, and whose infrastructure they use, are deprived for the budget revenues. In a globalized economy, behavior of multinational companies as "free shooters" is unacceptable in relation to the rest of the world.

The view of the OECD, or of some of the leading people in this organization should be nowhere, as they argue that the benefits of globalization certainly far exceeded its costs, and that in a market economy it is natural that everyone strives to create greater benefits with the least cost. The OECD does not see a way to solve problems, or to prevent the "game" of transfer pricing and "tax havens" and is therefore safe to say that this fiscal problem is deeply involved in all spheres of the global economy and that the solution is not yet in sight.

8. MEASURES FOR PREVENTING NEGATIVE TAX IMPLICATIONS OF TRANSFER PRICING

Planning of transfer pricing strategy, work on the limitation of exposure to taxes and on the practice of determination transfer pricing on a global scale, require knowledge of the complex network of tax laws of the country, regulations, decisions, methods and requirements. (Plasschaert 1994, 1-21)

As income tax is one of the most significant government revenue, its avoidance directly affects the balance of the state budget. More intensive process of globalization and the associated growth of multinational companies have made the problem of tax evasion even more important. (Smith 2006, 165-171) It was recognized that transfer prices are not only accounting technique, but a method of resource allocation that directly affects the distribution of income, wealth, risk, and thus determines the quality of life. Transfer prices are said to be "the most problematic area of international taxation."

There are three reasons for this opinion:

- First, globalization creates an integrated business with a high level of international transactions, while tax systems continue to operate at the national level.
- Second, governments believe that globalization offers multinational companies many more options for manipulating transfer pricing and minimize tax, than it has been possible in the past. Therefore, it is necessary to adopt more stringent regulations to regulate this area.
- Third, the tax authorities also require stricter regulation in the area of transfer pricing in order to protect the revenue from income tax.

Developing countries, as a rule, avoid introducing any control of transfer pricing, in a fear of a negative impact on the inflow of foreign direct investment. Another reason is the experience in implementing of control mechanisms and procedures to prevent arbitrariness in the use of transfer pricing. The simplest way for states to prevent avoidance of the corporate income tax with the help of transfer pricing manipulation is the adoption of the relevant law on corporate profits. (Gulin 2005, 12-15.) A necessary step in this process is the establishment of mechanisms for the implementation of the adopted regulations.

Many states have resorted to new legal solutions, which will allow tax authorities subsequent correction of the financial statements in the case of a lot of unfairness in relation to transfer pricing, and the additional tax collection based thereon.

9. CONCLUSION

Tax competition is a concept that is as old as the tax, and states have always tried to made their tax system more attractive not only for individual taxpayers, but also for large investors. In this sense, it is a phenomenon which is an integral part of the tax system leading even to their improvement. However, a special problem is unfair tax competition. This is particularly evident at the present time, when there is present globalization of economic activity and increasingly crossing of national borders by capital, labor and services, i.e. mobile economic activities, not only within the jurisdiction of individual states, but the state itself.

In this regard, each country tries to offer better conditions for the pursuit of economic activity and investment. Particular attention is paid to the tax conditions and the tax treatment of the company in a way that the base of the corporate income tax is significantly expanded, while the tax rate decreases and almost approaches zero or even completely disappears. Consequence of this behavior of the states is not only a significant attrition of tax base, but also creating a very "unfair" tax environment compared with operating conditions of subjects in the neighboring countries. All this further leads to fact that the economy of other countries is faced with losses.

The tax treatment of transactions that take place between companies that are connected under the wing of a single umbrella corporation is essential for the operation of each member of the group individually, and for the group as well. Tax authorities around the world increasingly turned their attention to this problem, which is understandable, especially when you take into account that today the majority of world trade takes place just between related parties, with existence of opportunities for tax savings, which are created by adapting their relationships to ultimate interests of a group. The

negative consequences of moving profit to states with more favorable tax regime, which can be achieved through harmonization of transactions taking place between related parties operating in different jurisdictions, are one of the key reasons of tax harmonization within the European Union.

Based on all the above, one may safely conclude that the hypothesis: "Transfer pricing significantly affects the creation of international tax issues," is defended and that there are sufficient facts that speak in favor of it.

At the very least, it is necessary to consider the potential resolving of fiscal problems: transfer pricing - "tax havens". Is it possible to put under the control „suspicious“ operations of multinational companies and offshore business? This question can not be fully answered, since even some of the greatest world economists do not find a solution to this problem. It is possible that all of this is inevitability with which we have to deal constantly, because it is so dictated by global powers.

However, the current financial and economic crisis has brought something good, because Western governments, cooperating with each other in difficult conditions of globalization, slowly tighten rules relating to "tax havens" and the collection of taxes from MNCs.

In order to prevent this behavior and eliminate harmful effects already incurred in the EU and internationally, within the framework of the OECD there have been taken appropriate measures to combat harmful tax practices. Within the EU, the conditions are strictly prescribed and member states are required to ensure that these conditions are respected. However, bearing in mind that these demands are an integral part of the act which has no legal, but only a political character, such tax measures which significantly impair the principles of fair competition are still present in many countries. A good example for this is Luxembourg, which despite being one of the oldest EU member states, has identifiable tax measures which are extremely unfair. Even the struggle that OECD leads at the international level has not had such great power, since the individual member states "disregard" the requirements of the Organization.

Deep system rootedness of forces of corruption in our democratic structures, can and shall be put to rest. Methods for solving this problem will impose by themselves, when everybody starts to realize that the benefits of MNCs will not for long time overcome the damage these corporations do.

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