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¶ 101 What is Transfer Pricing?

“Transfer pricing” refers to the pricing of transactions between related entities for goods, services, intangible property transfers, rents, and loans. The transfer price determines the division of total profit between the related entities. As market forces do not necessarily control transaction prices within a related group, the United States and numerous other countries have enacted transfer pricing rules and increased enforcement efforts to prevent the use of improper transfer prices to shift profits outside the bounds of their taxing jurisdiction. Transfer pricing rules are complex and non-uniform, typically resulting in compliance and enforcement difficulties on a global basis.

¶ 110 The Origins of Transfer Pricing

Transfer pricing was not originally established as a tax concept; instead, transfer pricing was created as a managerial accounting concept. The origins of transfer pricing can be traced back to the end of the nineteenth century, when some companies developed into multi-segment businesses. Managers were faced with the need to price intercompany transactions to better reflect the profitability of each segment and maximize the overall profitability of the firm.¹ Transfer pricing was therefore a management accounting tool to help administer the far-flung operations of large organizations. Consistent with this understanding, transfer

¹ See Robert G. Eccles, “The Transfer Pricing Problem, A Theory for Practice,” p. 16, Lexington Books (March 1986).