What is Transfer Pricing?

Worksheet

Transfer pricing is the price set for transactions between related entities within a company, determined via cost-plus, market-based, or negotiated pricing methods.

Questions

1. A subsidiary's unit cost is $50 with a 20% markup. What is the cost-plus transfer price?

A) $60
B) $70
C) $55
D) $65

2. Which transfer pricing method uses the price charged to external customers?

A) Cost-plus pricing
B) Market-based pricing
C) Negotiated pricing
D) Standard cost pricing

3. Why do multinational companies use transfer pricing?

A) To increase employee salaries
B) To price goods/services traded between subsidiaries and manage tax allocation
C) To calculate depreciation
D) To set market interest rates

4. What is a key risk of transfer pricing across countries?

A) Currency stability
B) Tax authority scrutiny over profit shifting
C) Reduced production
D) Lower employee turnover

5. A division's production cost is $40/unit. With a 25% markup, what is the transfer price?

6. An external market price for a similar component is $80. Using market-based transfer pricing, what price should the selling division charge?

7. Two divisions negotiate a transfer price between the cost floor ($30) and market ceiling ($70). They agree on $55. Is this valid?

8. Define: What is transfer pricing?

9. Define: What is the arm's-length principle?

10. Define: Name three transfer pricing methods.

Answer Key

1. A) $60 - TP = 50 1.20 = $60.
2. B) Market-based pricing - Market-based pricing uses a comparable external market price.
3. B) To price goods/services traded between subsidiaries and manage tax allocation - Transfer pricing prices internal transactions and affects how profit/tax is allocated across entities.
4. B) Tax authority scrutiny over profit shifting - Tax authorities closely monitor transfer prices to prevent profit shifting to low-tax jurisdictions.
5. TP = Cost (1 + Markup%) TP = 40 1.25 = $50 per unit
6. Market-based method uses external comparable price Transfer price = $80 per unit
7. Negotiated pricing allows any price between cost floor and market ceiling $30 $55 $70 valid negotiated transfer price
8. The price charged when goods/services move between divisions or subsidiaries of the same company.
9. Transfer prices should match what unrelated parties would charge in a comparable transaction.
10. Cost-plus, market-based, and negotiated pricing.