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Determinants of Transfer Pricing:

The case studies of Marchesi Group Srl and Eclisse Srl with their Romanian subsidiaries

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INTRODUCTION

Transfer pricing has always been a discussed subject, due to its variability in the way it is implemented and to the issues arising when companies must face it. It is a complex phenomenon mainly involving two fields of study: the first is the one related to what seems to be the only objective of transfer pricing, namely the allocation of profits among the subsidiaries and the parent company, and the other is about taxation patterns differing from market to market, which makes the process more intricate and problematic.

The aim of this thesis is to contribute to shed light on the topic of transfer pricing, by providing real-world case studies related to it involving two companies, Marchesi Group and Eclisse Srl, belonging to different industries but both controlling a subsidiary in Romania. The choice of methods will differ and diversities in the way transactions are carried out will arise. The work tries to focus on transfer pricing more from an accounting point of view rather than from a taxation perspective. The latter is usually predominant for the choice of the most correct method, and many factors and variables have to be considered, such as domestic content laws, tariffs, the place in which the subsidiary is located and consequently its regulations regarding transfer pricing. What is really important and has to be clear in mind is the fact that every situation must be singularly analysed and evaluated, as a model that suits every context doesn't exist, as you can notice from the plethora of articles and papers published throughout the years.

Kumar, Pandey and Lim (2021, p. 275) stated in their paper that "there is a need for transfer pricing research to go beyond compliance and tax management and toward a more meaningful exercise of using transfer pricing as a strategic tool in business". This is the direction this work wants to take: the attempt to understand if transfer pricing can represent a strategic tool for the concerning companies, or it is just implemented to comply with tax management. Sometimes considered as a tax avoidance practice, transfer pricing can in fact represent a useful internal tool for companies and multinational enterprises (MNEs).

The first chapter introduces the topic by providing a literature review starting from the first articles published in the mid-1950s until today. After presenting the concept of transfer pricing and introducing the generally accepted methods, the revision continues by providing examples of papers with their contribution to the study of this subject, identifying which was the tendency and the interpretation of transfer pricing of these academics and professors. The last part focuses on the OECD Guidelines, crucial for changing the perspective from the tax implications to the benefits its establishment can bring from the point of view of cost accounting.

In the second chapter the 5 OECD methods and their characteristics are presented, together with a description of the comparability analysis and the steps to follow to choose the most suitable method. Moreover, the last paragraph outlines the documentation that need to be submitted for the correct application of the transfer process. This chapter is supported by a glossary made up of words belonging to the field, all taken from the OECD Guidelines of 2017.

The third chapter represents a sort of introduction to the case studies, as it explains how the research has been carried out and what sources of inspiration helped in composing the questions.

Chapter four deals with the first case study of Marchesi Group. A detailed presentation of the company and its history opens the section, followed by a portrayal of the vision, strategy and management system. Then the global presence of Marchesi is emphasized through the presentation of its worldwide locations, besides the sectors in which operates and the manufacturing activities performed. The last part is about transfer pricing, the method chosen for the transactions between the Italian parent company and the Romanian subsidiary, including descriptions of the different situations characterizing this relationship. At the end some considerations on these dynamics are made.

The last chapter relates to the other case study, the one of Eclisse Srl. The structure is quite similar to the one used for Marchesi Group. After introducing the company and its history from its foundation, its mission together with the theme of innovation and certifications of quality are presented. Then, after listing all the products offered by the company, a paragraph about its global presence serves as introduction to the one of transfer pricing, with the analysis of the Italian-Romanian transactions and the way in which they are managed.

At the end, a conclusion summarizes the content of the thesis, offering some more insights, comments and feedbacks about the research and the investigation.

CHAPTER 1

Literature Review

"There is possibly no single accounting topic that consumes more management time and energy in multi-profit centre companies than the business of establishing acceptable transfer prices. The expenditure of energy in this area far exceeds that expended on pricing products sold to outside customers" (Seed, 1970).

Starting from that quotation, it's fair to claim also that trying to do a review of what have already been done in the field of transfer pricing is something that requires a lot of time and effort, but it's crucial in order to understand and comprehend the dynamics behind this often-disregarded phenomenon. Since the first articles published in the 50s, the topic has been analysed by several professors, academics and scholars, who have tried to find the secrets of the nature of transfer pricing, and above all, to establish a rule that could have been considered universal. But over the years, they realized that the choice of a given transfer price is something subjective, beyond, and maybe even outside the scope of developing a model that could fit every situation. Indeed, what they tried to do was to propose models to be used by firms or multinationals depending on the different circumstances in which they were operating. Most of the papers and articles published in the second half of the 20th century dealing with the issue of transfer price and its settlement are early studies trying to investigate the argument and to which is necessary to add further research carried out during the first years of the 21st century up to our days. So, in order to move forward with additional inquiries and investigation, ranging from general ideas to possible more specific case studies, it is essential to assimilate past concepts, theories and notions so as to avoid mis-understanding and -interpretation.

1.1 Definition of transfer pricing and generally accepted methods

After having read and analysed several interpretations and explanations of what a transfer price is, a general definition can be the following: a transfer price is the price used to value the transfer of goods or services between divisions within the same company. A significant role is played by the so-called intermediate products, that are the goods transferred from the supplying division to the receiving division, which eventually processes them further before selling them as final products to the outside market. The transfer price of the intermediate product represents a cost to the receiving division and a revenue to the supplying one. Therefore, in simple words, transfer prices are used to determine how much of the intermediate product will be

manufactured by the supplying division and how much will be acquired by the receiving division.

Great consideration has to be given to globalization and the consequent creation of opportunities for business and firms to exploit features such as raw materials, labour, manufacturing capacity and even intellectual property that may be in short supply or even not available in the home country. These are possible reasons at the basis of the birth and rise of multinational corporations (MNCs) having divisions in several countries. In this context, transfer pricing is the key for the profitability of globalization and specialization.

Transfer pricing has different purposes, such as providing information that stimulate divisional managers to take beneficial economic decisions or that is useful to assess the managerial and economic performance of the divisions, and ensuring that divisional autonomy is not compromised. The common goal should be the establishment of a transfer price that encourages managers to do what is in the best interest of the company and the divisions. In a few words, to maximize the overall company profit. But this is not always the case, because for instance, transfer prices can be used to intentionally move profits among divisions, above all the ones located in different geographical areas. The problem arises when distinct perspectives are used to establish a transfer price, namely the point of view and context used to tackle the problem: for instance, some scholars treated the topic as crucial for the management accounting of the firm, while a large group of academicians focused on its tax implication. These different approaches focus on what can be considered the objectives of transfer prices, so they can regard tax strategy and compliance or management design or the design of the supply chain structure, just to name a few.

Generally, the most suitable method is chosen among five broad systems (Drury, 2012, pp. 511-517):

1. Market-based transfer prices: both supplying and receiving divisions agree to set the transfer price equal to the market price. This happens when a perfectly competitive market for the intermediate product exists, meaning that the product is homogeneous, and no individual buyer or seller can affect market prices.
2. Marginal/variable cost transfer prices: setting the transfer price based on the marginal or variable cost (accountants consider them to be equal) of producing the intermediate product for the supplying division. This is an incentive for both divisions to get the optimal output level of production, above all in short time perspective. On the other

hand, this method is not widely used because of various reasons: it provides poor information for performance evaluation, given that there are other types of costs to consider; the marginal cost may not be constant over the entire range of the output, since they can have different kind of behaviour; it is complicated to measure it on a short-term perspective, that generally is rejected by managers. So, it is adequate for the company as a whole, but it results in a poor measure of divisional performance.

3. Full cost transfer prices: the transfer price is set at the full cost of producing the item, so variable and fixed together. Since managers often require an estimate of long-run marginal cost for decision-making, this method is fairly used. But the downside is that it doesn't enable the supplying division to get a profit on the goods or services transferred. Who is selling the good is just covering the costs without getting a profit.
4. Cost-plus a mark-up transfer prices: setting the transfer price as the cost plus a percentage that represents the gain for the supplying division. This method attempts to meet the performance evaluation purpose of transfer pricing because profits are allocated to the supplying division, but it results in non-optimal decisions because the transfer price exceeds short-run or long-run marginal cost. Beside that, huge mark-ups can result when goods are transferred between several divisions.
5. Negotiated transfer prices: it happens when managers of both divisions negotiate the transfer price between them, taking into consideration the market price and the costs of the product. This method is adequate in presence of market imperfections for the intermediate product, so when there are several different market prices, and of managers having equal bargaining power and able to use cost and revenue information. This in general will help both divisions to get the best solution. But on the other hand, it can lead to sub-optimal decisions, it is time-consuming, divisional managers and their bargaining skills and powers can strongly influence divisional profitability, it is inappropriate in certain circumstances, such as when a market for the intermediate product or an imperfect market doesn't exist.
6. Marginal/variable cost plus opportunity cost[1]: this is often cited as a general rule leading to optimal decisions for the whole company, but in reality it is just a restatement of general principles claiming that with no intermediate market the transfer price is set equal to the variable or marginal cost, while with the presence of an intermediate market

[1] The opportunity cost can be defined as the contribution, profit or revenue that is gone by deciding to buy within the company compared to the market, or the contribution foregone by the supplying division from transferring internally the intermediate product (Drury, 2012).

the transfer price is set equal to the market price, that is the sum of the variable cost and the opportunity cost.

	ADVANTAGES	DISADVANTAGES
Market-based	• Divisional autonomy • Corporate profit maximization • Goal congruence achieved • Realistic performance evaluation	• Market price may be temporary • Possible absence of an equivalent market price • The external market can be imperfect
Marginal/variable cost	• Optimal output level of production for both divisions	• Can lead to bad decisions • Only the receiving division will get a profit • No incentives for control of costs • Supplying division doesn't cover its fixed costs
Full cost	• It offers an estimate of long-run marginal cost for decision-making	• Supplying division just covers its costs without getting a profit • Pricing decisions based on past costs are questionable
Cost plus a mark-up	• Easy to understand and apply • Adequate for low-risk, routine transactions without many variables	• Possibility of excessive mark-ups • Unavailability of reliable data
Negotiated	• More realistic measure of divisional performance • Buying division can purchase the product at a lower cost than that of its competitors • Selling division's manager is more conscious of cost control	• Time-consuming • Possibility of conflicts between divisions • Outcome may not be optimal, due to inequalities in bargaining skills and power of managers

Marginal/variable cost plus opportunity cost	• Both divisions produce and consume the optimal quantity for the company	• Difficulty in measuring opportunity costs • Nature of transferred goods (their uniqueness)

Table 1: Advantages and disadvantages of transfer pricing methods (Our own elaboration).

1.2 Contribution of past works

Just skimming through the pioneering works, a thing that stands out is the attempt to involve the transfer pricing choice into a framework for decision-making, especially with respect to sourcing or make-or-buy decisions, and not using it only to allocate profits among the parent company and the subsidiaries or to avoid additional tax payments. Unfortunately, this last one standpoint has been the most inspected one throughout the years, often leaving aside managerial implications and relevant patterns such as the provision of information to divisional managers about the cost and profitability of intracompany transactions, or the attempt to push divisionalized subsidiaries to achieve the full profit potential for the firm.

In the past, with the publication of the first papers on the topic, transfer pricing was a typical notion of managerial accounting. So much that the first studies did not concern the fiscal problems relating to transfer pricing but dealt with aspects of a purely managerial nature. Who can be considered the one who have laid the groundwork of the studies and analysis of this subject is Hirshleifer (1956) with its paper "On the economics of transfer pricing", in which he addressed the issue starting from basic circumstances and the simplest case and analysing the several ways transfer price can be set in a tax-free world. Along with Cook (1955), they were the first ones to deal with the trouble of setting prices for transactions within companies built on decentralization. Their works proposed examples of situations in which profits for the firm as a whole were reduced by rational decisions of sub-units' managers, coming to the main problem of transfer pricing that is not zero-sum.[2] The work of the American economist is cited in almost every bibliography of the following works, since it constitutes the basis from which to start an investigation. Beside them, a wide circle of researchers made an effort to give a personal contribution to the matter, increasingly giving relevance to it.

[2] A transfer price seems to have a zero-sum effect because it is the revenue of one division and the cost of another division, so the revenue and the cost are equal and opposite in effect (McAulay and Tomkins, 1992, p. 106).

It’s impossible, or at least improbable, to condense in just a few lines of a paper such a general and broad topic as transfer pricing. Choosing a clear-cut feature, peculiarity or trait is the best and most appropriate way to face the issue. For instance, Lall (1979) with its paper “Transfer pricing and developing countries: some problems of investigation”, analysed the designation of transfer prices in commodity intrafirm trade concerning transnational companies (TNCs) and less developed countries. One of the main questions he tried to answer is if for a TNC subsidiary is convenient to buy intermediate products from the parent company, from foreign suppliers or from domestic suppliers. What he found is that a unique answer doesn’t exist to that inquiry, that could be generalized to other cases, because it depends on several factors such as the relative cost, reliability and performance, or also the host government policy about imports and local purchases.

Regarding resource allocation, Amershi and Cheng (1990) provided a general theory for decentralized firms characterized by information asymmetry, focalising on the importance of the accounting control system in operationalize mechanisms for the allocation of resources, crucial for facilitating coordination and control in the company.

Another model is presented by Holmstrom and Tirole (1991), who focused on the relationship between transfer pricing and organizational form of the firm, trying in some way to conciliate them through a model which deals with the fact that the organizational form of a firm, and in particular the degree of decentralization, is a crucial determinant of transfer pricing policies. They stated that “Transfer pricing is just one instrument in the overall organizational design”. So, the spotlight is evidently on that distinct aspect.

McAulay and Tomkins (1992) proposed in their work a scheme (Figure 1) in order to show the interactive nature of variables and mechanisms which influence transfer pricing. It’s clear that, after having been introduced in the system, transfer prices affect several variables including goal congruence, motivation, fairness, resource allocation and autonomy.

This strengthens the idea by which transfer pricing is central in the structure design of a company and necessary for the achievement of corporate objectives, the facilitation of performance evaluation and the fair share of divisional autonomy. Besides corporate characteristics, there are other variables that impinge on transfer pricing, whether they be external (rate of change, tax regulations, nature of markets for intermediate goods), individual

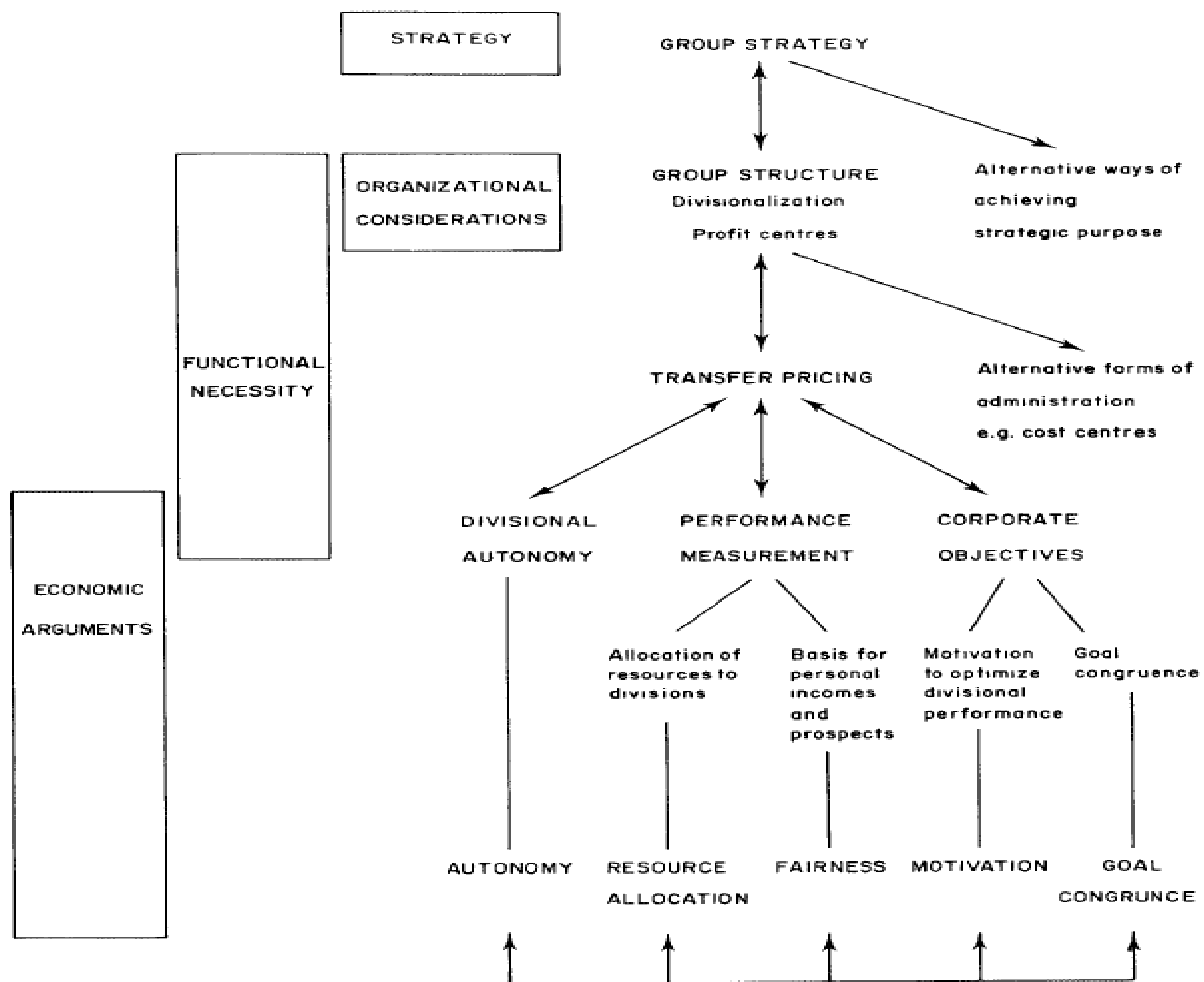


Figure 1: The purpose of transfer pricing (McAulay, L., Tomkins, C.R., 1992. A Review of the Contemporary Transfer Pricing Literature with Recommendations for Future Research. British Journal of Management, 3, 101-122).

(opportunistic behaviour, participation, personal knowledge and experience), or regarding administrative (cost information, credibility, determination of fair profit) or transfer characteristics (nature of products, value, frequency and volume of transfers, existence of market prices). All these conditions have to be considered when managing transfer prices.

In the same year, Borkowski (1992) model put transfer pricing in a framework for decision-making in an organization, claiming that every decision taken inside the firm is conditioned by a combination of environmental, organizational and international features. So, managers have to be able to interpret and perceive in the correct way these factors when choosing the most favourable and desirable transfer pricing method.

Alles and Datar (1998) developed a model with two oligopolistic firms that strategically select their cost-based transfer prices, rather than focus on the motivational implications of cost systems. Here they "formalize the link between the determination of marginal product costs and

the ultimate use of that information for pricing". The consequence is that there is a strategic component in transfer pricing settlement, and the goal is to involve the corporate's choice of cost-based transfer prices in the context of the general competitive environment. With the model proposed, they also demonstrate the possibility of cross-subsidizing products to maximize their capability to raise prices in the strategic setting. The innovative aspect offered by this work is that it concentrates on the promotion of strategic transfer price synergy between firms competing in oligopolistic markets by arranging transfer prices in a way they exceed marginal costs, unlike aiming attention to the alignment of interests within the firm and its decentralized divisions, and consequently to internal performance motivation, control and evaluation. In a few words, the key is the externally role of cost and the system in general, because the decision for a determined transfer price is assumed to be crucial for the price-setting mechanism. And lastly, the choice of the prices is not isolated, but part of a strategic framework in which firm's competitors are central. They conclude by saying that "costing is only a means toward the end of profit maximization, and not the end in itself".

The negotiated transfer pricing method had been analysed by Vaysman in 1998. In this paper he claimed that this method is more used in practice than the administered ones, in which transfer prices are governed by rules designated by top managers, but it has always been less investigated due to complications linked to the evaluation of the outcomes, dependent on the degree of sub-units' autonomy, the negotiation infrastructure and the bargaining skills of the managers. The approach takes into account the implications of divisional managers' private information, besides the negotiation and the structure of bargaining. This analytical work suggests that centralized transfer pricing schemes produce better results under perfect information, while information asymmetry is more suitable for decentralizing production and pricing decisions.

After a careful and detailed exploration of the articles and papers published during the years, what immediately strikes is the need to avail of case studies of firms or MNCs in the works, useful to refute what has been proposed or discovered in the theory and to have a test of its functionality in practice. Boyns, Edwards, and Emmanuel (1999) proposed a longitudinal case study of an iron and coal company (Pearson and Knowles) in the final quarter of the 19th century in order to employ in it three possible frameworks for the determination of transfer prices. One of the questions that arose was if transfer pricing policy is a result of strategy or a tool of strategic change. This can be transposed at the operation level wondering whether transfer prices are a determinant of the level of autonomy of subsidiaries or if it is conditioned by the

level of interdependence. One more insight offered by this study is that transfer pricing policy can be a mechanism to execute strategy, by considering firm's power, history and evolution. In this way, this system can be perceived as the means of ensuring a desired level of interdependence between subunits.

High consideration must be given also to companies' decision of the level of centralization and intrafirm allocations, which are affected by two broad sets of factors: information asymmetry and goal congruence. For the former, Dikolli and Vaysman (2006) provided us with helpful information about the influence of local knowledge on divisions' decision-making about, among others, quality control, scheduling, purchasing, advertising, distribution, or human-resource management. Some examples of relevant local knowledge, for the production or upstream division, include knowledge of current and replacement production resources and technologies; trade-offs inherent in product design and engineering; quality and reliability of local suppliers; alternative uses of constrained resources. For the marketing or downstream division, examples include current demand conditions; knowledge of various markets, channels, and customers; the competitive dynamics of the product market; competitors' prices and products. These are only some instances of the features to assess in order to determine the right level of decentralization, or how much authority delegate to divisions' managers. Doubts to be dispelled can be: what is the difference in information between the top management and the subunit manager? How much does the divisional manager know that the firm's headquarters (HQs) do not know? The bigger that imbalance, the more decision rights should be given to divisional managers because they possess the information to make a valid decision.

As regards goal congruence, the question to be asked is how strong the alignment between the divisional manager and the top management of the firm is. The increase of this level of coordination can be also favoured by compensations given to subsidiaries managers based on firm-level performance, because in this way they are stimulated to do well not only at the division level, but also at the firm's one. When that happens, the divisional manager receives a greater amount of decision rights. Therefore, top managers have to encourage divisions to act and take decisions that will maximise firm's profit, by providing divisional managers with incentives aligned with the corporate objectives.

Beside the helpful advice on information asymmetry, Dikolli & Vaysman (2006) presented how transfer pricing is affected by more or less improved information technology[3] with particular reference to the method of negotiated transfer pricing. They found that information technology plays an important role in transfer prices choice as a management control tool for MNCs. They noticed that top managers prefer the cost-based method over the negotiated price method, since the negotiations can conceal the strategic objectives of transfer pricing. In addition, bargaining over transfer prices can result in a waste of a great amount of time useful for other productive activities, or can lead to the loss of market opportunities, or again, in the case of misunderstandings between managers, can cause conflict and poor decision-making. Examples of private information possessed by local managers can concern business processes, local conditions or potential cash flows. They stated that "it is the ability to communicate knowledge to top managers and others that is a key factor determining the preferred transfer-pricing method". Furthermore, negotiated pricing becomes more attractive as the difficulty to transfer the local knowledge of the supplying division increases. Transferring local knowledge has costs that are influenced by several factors such as the firm's size, the nature and complexity of local knowledge, the cultural and educational backgrounds of subunits and top managers, the technology for communicating local information, the necessity for rapid responses to changes in local conditions, and the geographic reach of the firm. The results of the work by Dikolli and Vaysman (2006) show that a key factor in the determination of a transfer pricing method is the firm's informational environment.

After having analysed these nuances of transfer pricing, the most important and double aspect of transfer pricing can be considered, as an accounting and taxation practice: in fact, two streams of thoughts can be identified, one relating to the management control issues and implications with reference to divisions' performance evaluation and internal decision-making, so dealing with operations such as resource allocation, cost determination of the goods and services involved, all pursuing sales growth. The other stream concerns tax accounting studies on international transfer pricing and income shifting: they investigate to which degree national tax differentials lead to transfer pricing manipulations in MNEs, due to the fact that often prices are exploited in order to reduce the tax liability of the firm as a whole. An investigation on the latter has been brought forward by Sikka and Willmott (2010), who sought to highlight the role of transfer pricing in facilitating tax avoidance, by claiming that it is not only an accounting

[3] Information technology (IT) is the development, study, or use of electronic equipment, especially computers, for storing and analysing information. (Oxford Learner's Dictionaries)

technique, but also a method of resource allocation and tax avoidance affecting the distribution of income, risks, wealth and quality of life. By providing some evidence of the improper use of transfer pricing in emerging and developed countries, one of the features that emerged was the deviation of contracts toward the so-called tax havens, while multinational companies allegedly exchange goods between different countries in a licit way. This leads to a more general consideration concerning the huge increase in corporate power and global trade, which allows for a large number of opportunities for planning transfer pricing strategies to avoid taxes, in this way putting in trouble institutions commissioned to control such transactions and ensuring that the law is kept. One last point deals with the two terms tax avoidance and tax evasion: the former is considered to be lawful, so a sort of circumvention of the rules, while the latter refers to actions that infringe the law.

On the other hand, Shantanu (2012) supported the opposite idea, the fact that tax liability management often is given less priority in the moment of pricing international transactions, even though it continues to have great power in affecting certain strategy. Refusing the fact that transfer pricing is not restricted to tax liability management is a sign of little openness towards other possible reasons for non-arm's length pricing, as strategic requirement and risk or investment management. International transfer pricing can be used as a management control tool to facilitate the assessment of business units' performances, or to manage the risk for a MNC of entering a new market.

According to Martine Cools (2014), the two currents of thoughts are linked in a third stream of empirical transfer pricing studies. This tries to target the understanding of the impact of the growing need for transfer pricing fiscal compliance on the design and use of the management control system within multinational enterprises. What she tried to do is to treat management control and taxation together and not as detached matters, stating that the latter has a compelling influence on the organization's management control system.

The predisposition towards the managerial and corporate management or fiscal and tax aspect of transfer pricing determines the company approach to its dynamics. When the gap between the two areas broadens, it means that the company pays attention just to one of the two approaches, consciously or not accepting the consequences of neglecting the other one.

It is fundamental to quote a statement by Martini, Niemann, and Simons (2012, p. 1061-1062): "The main aim of transfer pricing according to the managerial accounting literature is to coordinate decisions under decentralization. This suggests that TP was originally designed to

influence decision behaviour, in particular through its impact on performance measurement." This is a pure managerial view of transfer pricing, not taking into account tax implications, despite the notable increase of transactions in international markets caused by continuous business integration. In fact, most of these transactions are international related-party sales. Consequently, in examining production decisions and investments, they placed themselves in a domain to be able to dig into the organizational structure and the accounting regime implemented by the firm, leaving aside every finance perspective.

Another interesting facet that is worth mentioning is the possibility to adopt a double accounting or two set of books by MNCs, one for management purposes (internal performance and profit measurement) and the other for tax reporting purposes. Nevertheless, most of the firms continue to maintain just a single set of records, due to the advantages deriving from it, such as the reduced cost of financial recordkeeping and the consistency between internal and tax reports; but also due to avoidance of possible disputes with tax authorities when differences arise between internal and external valuations.[4]

1.3 The importance of the OECD Guidelines

A milestone in the study and also in the perspective choice has been the publication of "Transfer pricing and multinational enterprises" in 1979 by OECD, that set the rules of intracompany transfer pricing. From that point forward, transfer pricing is not treated almost only as a strategic tool for the business, so used in a way to improve the quality of the structure, evaluation and relationship between the firm and the divisions, but also and above all, for tax reporting purposes. In some way they shed a light on how a firm can diminish its worldwide tax liability within the boundaries of the arm's length standard. This set of rules has been repeatedly updated and supplemented by different reports through the years, and it is revised on an ongoing basis, mainly due to the progress of economic integration which leads to a dramatic growth of intra-firm trade and consequently to more opportunities for tax manipulations through transfer pricing. Today the official name is "OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" and the last revision dates back to 2017.

A great review was made in 2010, year in which a new version of the guidelines was approved. From that point on, with an increasingly regularisation of transfer pricing practices and the

[4] Hiemann, M., Reichelstein, S. (2012). Transfer Pricing in Multinational Corporations: An Integrated Management and Tax Perspective. In W. Schön, K. Konrad (Eds). *Fundamentals of International Transfer Pricing in Law and Economics* (pp. 3-18). Heidelberg: Springer-Verlag Berlin Heidelberg.

growth of tighter controls by institutions, the focus of most of the works of the last decade shifted from the managerial implications of transfer pricing to the search of the most adequate and precise ways to carry out the process for the determination of the proper transfer price.

Although these guidelines have not meaningful legal force, which means that OECD has no regulatory responsibility or instruments within its control, they play a central role in the correct choice of transfer pricing method. As McMahon, Corcelius and Smith (2013) describe in their paper, the concepts introduced by OECD of identifying comparable companies or products and preparing country-specific documentation have started to enter the discussion, widening the range of feature to take into account. Beside that, they recognize 4 positive effects on the foreign country created by the MNCs, specialization and globalization: the creation of job for the citizens; the income tax revenue from the newly employed citizens; the corporate income tax revenue from the MNC; the transfer price revenue from the MNC. But these, on the other hand, affect in the opposite way the home country and its government. This divergence can be healed with a precise and accurate tax planning in which a strategic transfer pricing should be integrated.

Other numerous articles deals in a more detailed way with the subtopics introduced by the OECD Guidelines: Mura, Emmanuel and Vallascas (2013) performed a test to check how reliable the comparables are using profit-based transfer pricing methods, so the Transactional Net Margin Method and the Profit Split Method (or Comparable Profits); other two method, the Comparable Uncontrolled Transfer Price (CUP) and the Cost-Plus, are involved in the paper of Behrens, Peralt and Picard (2013/2014 ???), in which they developed a model to analyse the impact of these recent rules on prices and pricing decisions, organizational structure choices, tax revenues and consumers' utility; Hammami and Frein (2014) took advantage of the Profit Split Method (considered a novelty in the topic examined) to integrate transfer pricing in the large scale optimization model developed in their paper related to the supply chain redesign problem; Plesner Rossing and Rohde (2014), based on a literature review focused on the findings about the several kinds of transfer pricing, presented a sort of scheme (Figure 2) useful to guide future research of the subject. All the elements of the framework revolve around its core, the transfer pricing system, that is a function of the variables regarding the context and the ones related to the outcome. A note to make is that all these principles and aspects are more and more influenced by the increase in number and complexity of transfer pricing regulations, most of all within different tax systems. First of all, a transfer pricing system can be impacted by three different kinds of context variables: external (tax systems, tax authorities), internal

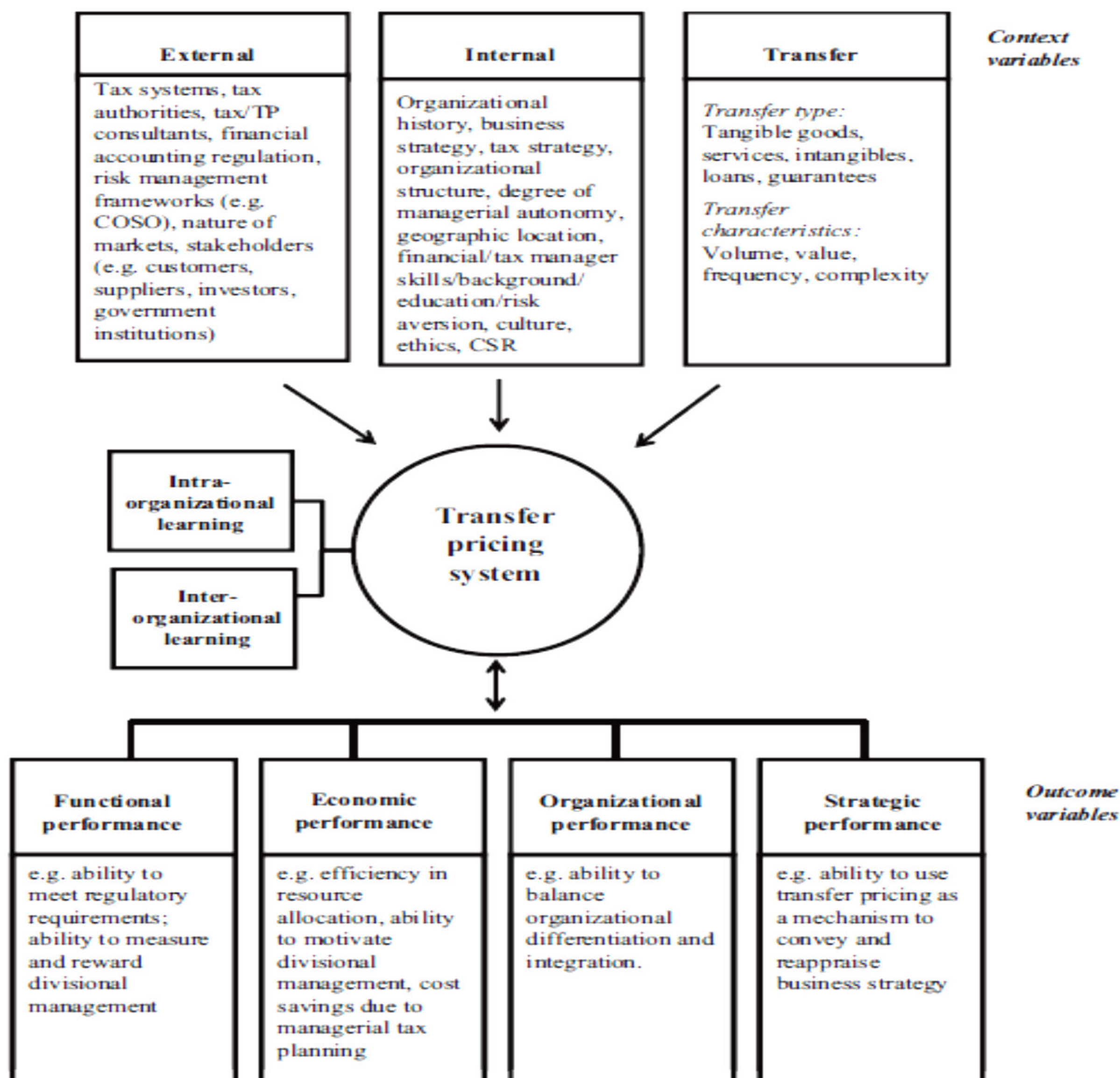


Figure 2: A framework for transfer pricing research (Plesner Rossing, C., Rohde, C., 2014. Transfer pricing: aligning the research agenda to organizational reality. Journal of Accounting & Organizational Change, 10(3), 266-287).

(business strategy, organizational structure, culture) and transfer, or intra-group (type and characteristics of the transfer). Depending on the number of variables acting individually or in combination, the transfer pricing system of the organization can be more or less affected. For what regards the outcome variables, four performance dimensions are presented, taken from the four arguments about the existence of transfer pricing (McAulay and Tomkins, 1992): the functional, economic, organizational and strategic performance. The logic and the idea behind this relationship is that the transfer pricing system should be thought of and treated as multidimensional, because it doesn't have just one universal performance dimension. As a

consequence, arrangements and adjustments on a performance in one or more dimensions to fulfil other objectives are something usual and a daily occurrence for a transfer pricing system.

An interesting, curious and engaging inquiry is posed by Plesner Rossing, Cools and Rohde (2017), who presented instances of the main features of international transfer pricing, together with a clear and concise explanation of the most important concepts of the OECD Guidelines, and then proposed to the reader a case study of a fictional MNC in order to apply correctly the rules present in the guidelines, with a consequent discussion on international transfer pricing, in particular within the context of responsibility accounting. It proved to be really useful and helpful for the understanding of these complex mechanisms, because it invited the reader to put his/her theoretical knowledge into practice, even though for an imaginary case. And again, Kato and Okoshi (2019) suggested a model in which the CUP Method and the arm's-length prices (ALP) concept are central, especially the latter because it is involved in the investigation of its impact on the production location choice and on MNCs' tax avoidance. Also Huang and Ohmori (2021), who dedicated to try to balance the trade-off between the total profit of a global group company and fairness by transfer pricing, cited the methods set by the OECD as a way for firms or MNCs to prevent illegal dumping for example. The two scales of balance should be valued, especially a sustainable objective as fairness is, in order to support the efficient objective of total profit: thus, companies can have an improved economic cycle appropriate to aid fairness. Lastly, Jalan and Misquith (2021) illustrated how to conduct an adjustment process of what is considered the core of transfer pricing, namely the comparability analysis. Complications often arise, for example in finding a correct match between the identified comparable and the controlled transaction. To overcome these problems and reach greater comparability, different kinds of arrangements can be made, as shown in Figure 3. The first adjustments are the ones for accounting inconsistencies, which belong to the application of distinct statutory accounting principles or to dissimilar ways of classifying or reporting accounting items. Some examples are depreciation, foreign exchange or the use of

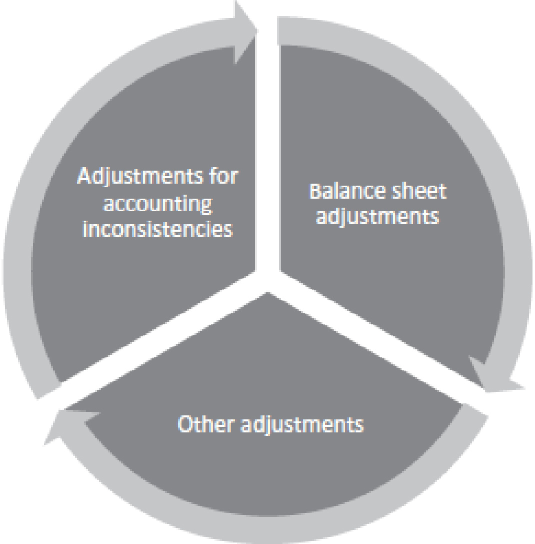


Figure 3: Transfer Pricing Comparability Adjustments (Jalan, N., Misquith, E., 2021. Comparability adjustments in transfer pricing and the need for a digital data intensity adjustment. Intertax, 49(6-7).

different methods to evaluate inventory. Balance sheet adjustments directly relate to parts of the balance sheet such as receivables, payables or interest rates. Two common ones in this section are the Working Capital Adjustment and the Fixed Assets Adjustments. Other adjustments refer to all the other arrangements of specific economic circumstances affecting the transaction that is being compared. Commonly used adjustments in different jurisdictions comprehend the Capacity Utilization Adjustment and the Risk Adjustment.

All these comparability adjustments can be defined as ever-changing, in order to be suitable for dynamic businesses and commercial realties. Even if continuously updated, practical challenges are always present, as it is shown in Figure 4.

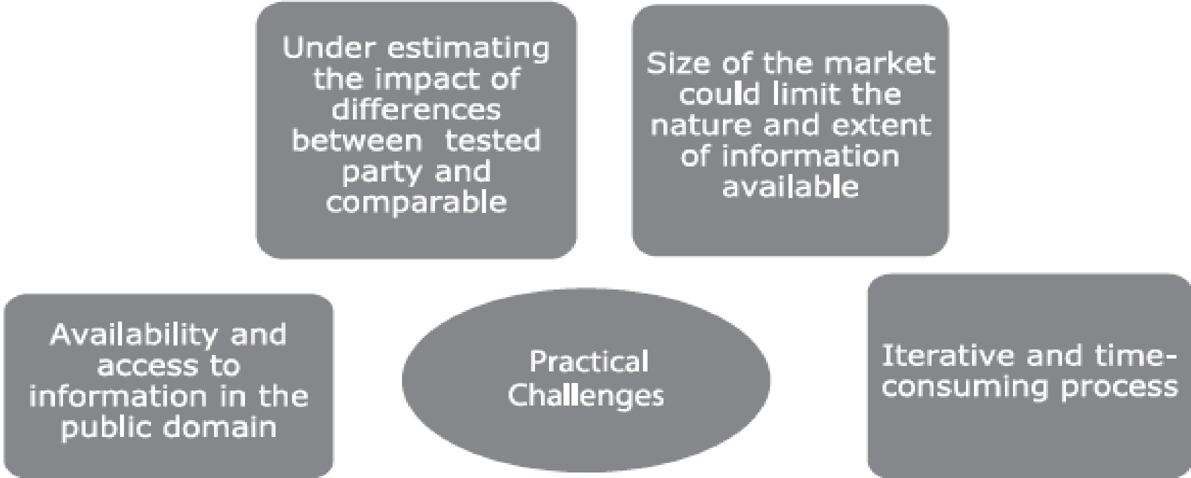


Figure 4: Practical challenges faced while applying comparability adjustments (Jalan, N., Misquith, E., 2021. Comparability adjustments in transfer pricing and the need for a digital data intensity adjustment. Intertax, 49(6-7).

This list of articles, although already rich and large, represents just a small portion of all the papers and studies published in different journals or websites. This just to confirm how much impact the OECD guidelines had on the subject of transfer pricing. In general, what is usually analysed is the consistency of transfer prices with the arm's length principle and then the impact of its choice or not on different decisions that have to be taken.

To conclude this review, despite the huge influence of these guidelines and the gradual shift of the sphere of interest for the argument, relevant questions about transfer pricing continue to need to be answered, especially in relation to internal consequences on firms. Indeed, continuous controversies surrounding this topic and its dynamics are an everyday occurrence inside companies. As most of the scholars have tried to do throughout the years, the objective

of this work is to shed a light on issues and inquiries concerning the choice of the most suitable transfer pricing method that can maximize domestic and international objectives, and the understanding of what the determinants of transfer pricing are, also with the help of two case studies. All that trying to focus on internal, managerial and organizational implications of transfer prices choice and to put aside, but not forgetting, tax implications that in any case constitute a fundamental portion in the discussion.

CHAPTER 2

OECD Methods

OECD (Organization for Economic Cooperation and Development) is an international organization instituted on the 30th of September of 1961, with the main purpose of stimulating economic progress and world trade. It can be considered an evolution of what was formerly called OEEC (Organization for European Economic Cooperation), established in 1948 to help the European Economic Community in the administration of the Marshall Plan and the allocation of US financial support, besides the implementation of economic plans for Europe's rebuilding. Originally composed by European countries, it then extended the membership also to non-European states, consequently changing the name in OECD. When it was founded, it had 20 member countries, comprising the European founder countries of OEEC plus Canada and the United States. Throughout the years it welcomed other States, reaching a total of 38 to date. All of them are typically democratic nations supporting free-market economies and with the same goal: defining policies that encourage and promote equality, prosperity, opportunities and well-being for everyone. Today it is a cornerstone for most of the laws and regulations for its member countries, it is worldwide known, and is crucial in this study because of a document regarding the methods used for the establishment of transfer pricing. The document is called "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" and is a revision of a report entitled "Transfer Pricing and Multinational Enterprises" first published in 1979. The first publication dates back to the 13th of July of 1995, after its original version had been approved by the Committee on Fiscal Affairs and the OECD Council. Subject to several revisions and updates, these guidelines are constantly and continuously inspected and renovated in order to put everyone in the right direction when facing the issue. They are accepted by almost all tax authorities and, by outlining regulations and rules on transfer pricing, they guarantee fairness and accuracy.

In the international context, the transfer pricing problem remained devoid of a fully defined discipline until the intervention of the OECD Council which, faced with a widespread need to regulate international investments and the activities of multinationals, explicitly addressed the issue of transfer pricing. The subsequent evolution of the discipline of transfer pricing, as a means of cooperation between states, has since begun to reflect the new international economic order, gradually established after the Second World War, and has given rise to a progressive

development of economic relations and a marked tendency to encourage the movement of persons, capital and goods globally.

A significant report that is worth mentioning is the one released on the 11th of February of 2020 and called "Transfer Pricing Guidance on Financial Transactions", the first time that OECD Transfer Pricing Guidelines involve advice and assistance on transfer pricing features of financial transactions. This will provide consistency in the interpretation and understanding of the arm's length principle and help prevent controversies and double taxation.

The arm's length principle is what everything is based on. Its statement can be found in paragraph 1 of Article 9 of the OECD Model Tax Convention, which laid the basis of bilateral tax treaties involving both OECD member countries and non-member countries: "[When] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly". In this way, the approach followed is to treat the divisions or sub-units of a MNC as if they were independent entities and check the nature of these transactions and whether their conditions differ or not from the ones that would be obtained in comparable uncontrolled transactions. In other words, an arm's length transaction regards a deal between two parties without any pre-existing relationship, so acting independently and in their own self-interest without influencing each other.

The analysis of comparable controlled and uncontrolled transactions is known as the comparability analysis, which is crucial for the application of the arm's length principle.

The determination of the price of a controlled transaction is the purpose of the transfer pricing method. Indeed, the valorisation of a controlled transaction based on the arm's-length principle is determined by the application of the most appropriate method given the circumstances of the specific case. Some criteria have to be considered in the choice of the best method: strengths and weaknesses of every recognised method according to the context and circumstances of the case; the suitability of the method considering the relevant economic characteristics of the controlled transaction; the availability of reliable information, especially related to uncontrolled comparable transactions, needed to apply the selected method; the degree of comparability between the controlled and the uncontrolled transactions, also considering the reliability of possible adjustments to eliminate the differences between the two.

2.1 The Comparability Analysis

The main purpose of the comparability analysis is to search and find the most reliable comparables, but this is just a single step in a process which is not unique, even though few differences are expected between procedures and techniques performed by professionals in the sector. In order to determine the most suitable method for managing the analysis, it requires a profound knowledge of the transaction to analyse and the detection of potential comparable transactions. Due to the fact that it is just a suggestion on how to conduct the investigation, differences in the results can be present and be the product of availability of information, professionals' competences and skills or effort and commitment involved into documentation.

Therefore, the suggested steps in the typical comparability analysis are the following:

1. Determination of the years to analyse: the reference is to the fiscal years covered by the analysis. It usually corresponds to a fiscal year, because modern and updated reports are required by documentation obligations.
2. General analysis of the economic circumstances: it is basically the study of the industry and environment (including its external aspects) in which the firm acts, plus competition and economic and regulatory factors, but without immediately focusing on the specific transaction in question. It is particularly useful to understand the economic circumstances of the transaction, by investigating taxpayer's conditions in both controlled and uncontrolled transactions.
3. Understanding the controlled transaction(s) under examination, based on a functional analysis in order to choose the tested party[5], the most suitable transfer pricing method for the circumstances of the case, the financial indicator that will be tested and identifying the comparability factors in order to select potential comparables. Normally, the tested party is the one with less complex operations, bearing the least risk and not owing significant intangibles.

   The comparability factors are the economically relevant characteristics of the transaction and can be categorized as:

   - contractual terms of the transaction, relevant because provide an explanation of the business terms, rights and responsibilities of the intra-group transaction, and useful

[5] It is the point of reference for comparison of the international transaction with uncontrolled transactions. OECD defines it as "the one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e., it will most often be the one that has the less complex functional analysis".

because of the valuable inputs for the functional analysis, such as assets owned, allocation of functions and risks assumed (if there are written agreements, they will be the starting point for a transfer pricing policy; if there aren't, the effective behaviour needs to be analysed).

- the functions performed by each of the parties, the assets owned and the risks to bear (functional and risks analysis) and how they affect the generation of value in the MNE, the surrounding circumstances and the industry practices. Some examples are R&D, manufacturing and distribution (functions); tangibles and intangibles like brand names (assets); input price fluctuations, inventory risk (risks).
- the characteristics of the property transferred (features and sales volumes, quality, reliability, availability in the market) or services provided. They are determined to assess if they suit the comparability with the market transaction.
- the economic circumstances, as geographic location, the competition, competitive positions of buyers and sellers, demand and supply levels, administrative regulations, cost of transport and productive factors, date and duration of the transactions. All these variables can have a potential impact on prices.
- the business strategies, such as pricing decision, market penetration, innovation and development of new products, diversification, expansion policies. A comparison needs to be done between the business strategy of the intra-group transaction and the one of potentially comparable market transactions.

The functional analysis is exploited to find and organize facts about a business in terms of its functions, risks and intangibles with the intention of identifying how they are allocated between the companies involved in the transaction. Basically, functions are the activities performed as a normal part of the operations by the entities engaged in the transaction. Generally, the more functions that a particular entity performs, the higher the remuneration it should earn, and its prices should reflect this. The risk analysis relates to the portion of the rate of return a company earns based on how many risks is bearing. Possible risks are market risks, so concerning potential losses caused by sales in an uncertain marketplace; inventory risks related to raw materials, work in progress and finished goods; credit risks; environmental risks.

A careful evaluation of these comparability factors is crucial in the choice of the transfer pricing method because it immediately allows to determine the applicability of internal comparables, and consequently the need to resort to external comparables.

4. Identification and review of internal comparables (if any) with whom the tested party performs transactions. There exist a number of reasons to prefer internal comparables to external ones, including a higher probability of being more suitable for the affiliated transaction as they occur within the context of the group's business; the immediate availability of more information about the comparable situation; the fact that one internal comparable may be sufficient to support a defence of the transaction under review, while using external comparables may require a wider base of support. Avoidable risks may occur when using external comparables without first trying to identify and examine potential internal comparables.
5. Identification of external comparables, considering their relative reliability. Sources of information can be the government, through statutory public filing requirements and government trade department publications; commercial databases; industry associations; knowledge of employees. Online databases are useful for identifying potential comparables and obtaining financial information about them. Two of the most renowned and used are the Amadeus Databank and Orbis, both developed by Burean Van Dijk. Orbis, in particular, is more extensive as it contains more than 100 million firms and MNEs around the world, whose prices of products and services are published periodically (McMahon, Corcelius and Smith, 2013, p. 62). Beside them, another one very used is the Bloomberg Database.

   This benchmark analysis to identify the potential comparable third-party transactions can be conducted in two ways: with the additive approach or the deductive approach. OECD don't give systematic preference to an approach over the other, without prejudice to the transparency and verifiability of the results.

   The additive approach starts with the taxpayer (or the person making the search) drawing up a list of third parties that can be considered suitable to accomplish potential comparable transactions, and, to confirm if they are acceptable comparables, information is collected on these transactions. Usually, this approach gives precise and explicit results as all the transactions of the analysis are carried out by well-known actors in the taxpayer's market. As this approach presents similarities with the one used for internal comparables, it may embrace both external and internal comparables.

   The deductive approach consists of a set of firms operating in the same industry and sector of activity, performing similar broad functions, without presenting clear differences in the economic characteristics. Fundamental in this process is the refinement of the list using publicly available information, such as databases or internet

sites, and selection criteria. An advantage of this latter approach with respect to the former is that it is more reproducible and transparent, besides the fact that is easier to verify because the focus is on the process and on the relevance of the selection criteria. Nevertheless, a limitation can be represented by the fact that the goodness of the outcome depends on the quality of the research tools (quality of the databases and availability of detailed information), that in some countries happen to be not enough reliable or useful.

If there is no public information about the transaction under analysis, a method based on profitability is preferred, such as the Transactional Net Margin Method (TNMM) because it depends on financial information of public firms that are listed in the capital markets, which have to publish relevant information about the management, the performance and the results of their work.

6. Choice of the most appropriate transfer pricing method among the five proposed by OECD, and depending on the method, selection of the relevant financial indicator used to test the ALP. Fundamental in the choice and application of the best method is the availability of information about comparables (so the proper implementation of steps 4 and 5). The profit level indicators (PLI) represent the profitability of the tested party and of the comparables, so what is checked is if the profitability of the tested party is in line with the comparables. Depending on the activity of the tested party (manufacturer or distributor), different PLIs can be chosen, for instance the return on sales (EBIT/Sales), the Gross Profit Margin, the Net Cost Plus Margin (EBIT/Operating Costs), Return on Operating Assets (ROA).
7. Identification of potential comparables. This step is made up of steps 4, 5 and 6 and it consists of the determination of the key characteristics that an uncontrolled transaction must meet in order to be considered a potential comparable.
8. Determination and application of comparability adjustments to the information contributing to increase the comparability with the transaction or the tested party.
9. Interpretation of the results and use of the data collected to contrast the price agreed in the transaction (or the profitability of the tested party) and the number of results from the selection of comparables.

2.2 OECD 5 Transfer Pricing Methods

The OECD outlined in its guidelines five main transfer pricing methods that can be used by MNEs and companies and are accepted by almost all tax authorities. Their main purpose is to arrive at the arm's length price by looking at comparable transactions or profits of similar third-party organizations. They are the following (Figure 1):

1. Comparable uncontrolled price method (CUP)
2. Resale price method (RP)
3. Cost plus method (CP)
4. Transactional net margin method (TNMM)
5. Profit split method (PS)

Depending on the object of the observation for the determination of the transfer price, these five methods may be subdivided into two categories (Figure 5): the first three of the list, so the CUP, the RP and the CP, are the so called traditional transaction methods; while the other two, the TNMM and the PS, are the transactional profit methods. The traditional transaction methods measure the terms and conditions of transactions made by third-party organizations or enterprises (the uncontrolled transactions) and then compare them with controlled transactions between related parties in order to guarantee they are performing at the arm's length price. The

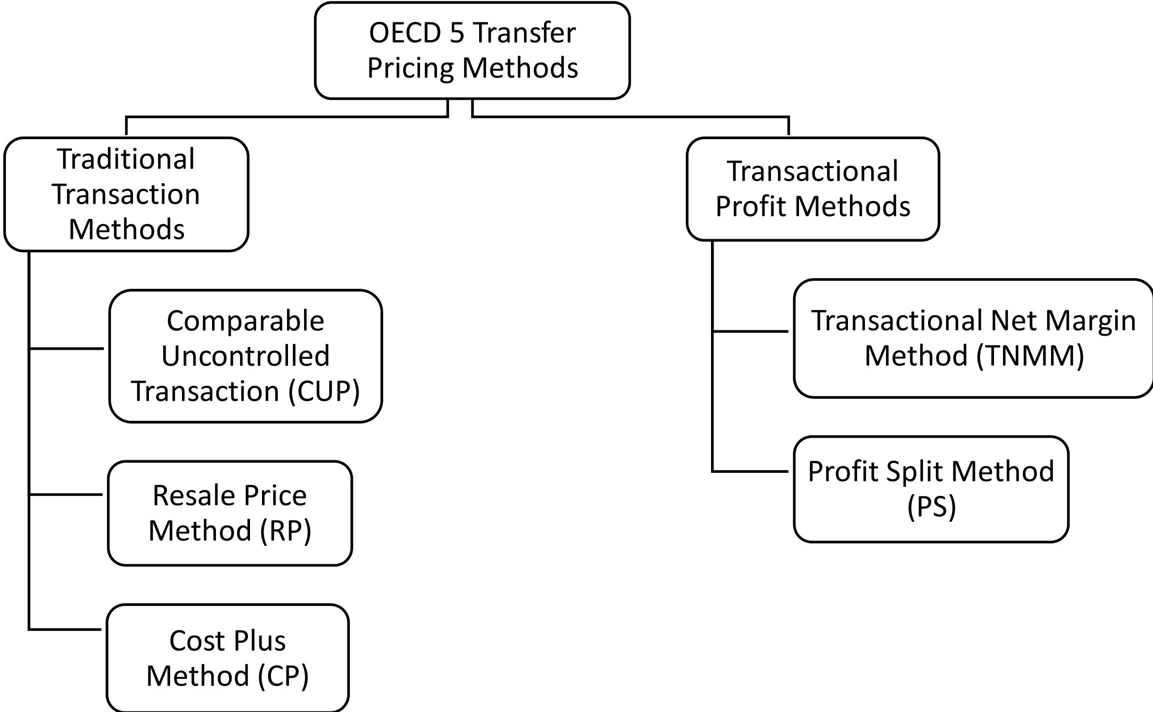


Figure 5: OECD 5 Transfer Pricing Methods (Our own elaboration).

concerned comparison can be carried out exploiting both direct, such as the price of a transaction, and indirect measures, for instance the gross margins of a particular transaction. In short, traditional transaction methods rely on actual transactions. On the other hand, the transactional profit methods consider the firm's profits as a whole. This means that the object under examination is not the terms and conditions of the transaction, but the net operating profits realized in controlled transactions, that then are compared to the profit level of third-party organizations engaged in comparable transactions. The aim of this process is to ensure that all the markups are arm's length. So, they rely on profit levels. A negative peculiarity of these methods is that they are less precise and accurate than the traditional ones. Another aspect characterising them is the difficulty in coming up with comparable data necessary to use them. Indeed, just a tiny variation in product features for example can cause a significant change in price. Nevertheless, these two methods are more often applied, because the traditional transaction methods require for their application detailed and specific information that is usually challenging and demanding to find.

The way in which the methods are compiled is not casual: they are listed in order of preference. In fact, the CUP should always be preferred over the others because it provides a comparable market price used to justify the transfer price. In case of unavailability of comparable market prices, and consequently impossibility of applying the CUP method, RP and CP methods are preferred because of their employment of gross margins. Again, if comparable market-based gross margins are lacking and the two methods cannot be applied, the TNMM or the PS methods should be used. What is important to understand is that there is no right or wrong method: everyone has its positive and negative aspects and features that must be analysed taking into consideration the firm's business model and the context in which it operates. In this way the choice of the most suitable method for the organization is made. Despite that, OECD asserts that if there is a situation in which the CUP method and another method can be applied in an equally reliable manner, the CUP method is preferred.

Below, the five methods with their characteristics, the way they work, risks and benefits are presented, following the order proposed earlier, divided in the categories identified.

→ Traditional Transaction Methods

1. Comparable Uncontrolled Price Method (CUP)

The CUP method is considered the most reliable, direct and effective way to apply the arm's length principle to a controlled transaction. It consists of a comparison between the price and

the conditions of products or services in a controlled transaction between related entities with the ones of an uncontrolled transaction between unrelated entities. The CUP can relate to an internal or an external market price. The internal CUP examines in contrast the price of a related-party transaction and the price of a comparable transaction between the related party and an unrelated party. In other words, the same product or service is sold by an MNE group company both to an external customer and to a group company. The external CUP instead considers the price adopted in a comparable transaction between two firms that are not part of the MNE group. This can be more difficult to find and that's the reason why the internal CUP is usually preferred.

In order to be effective, the CUP method requires a lot of comparable data and that's why it is used in presence of a significant amount of information available for the comparison. Beside that, the two compared transactions must be very similar to be defined as comparable. In fact, high standards of comparability have to be met by the uncontrolled transaction.

In practice, the CUP method has a great applicability in financial transactions, such as group loans, that are characterised by the presence of great amounts of data and for which market standards are useful for the determination of terms and conditions. Lastly, the method is suitable for the determination of prices of intellectual property (IP) that are charged for the use of licenses or brands.

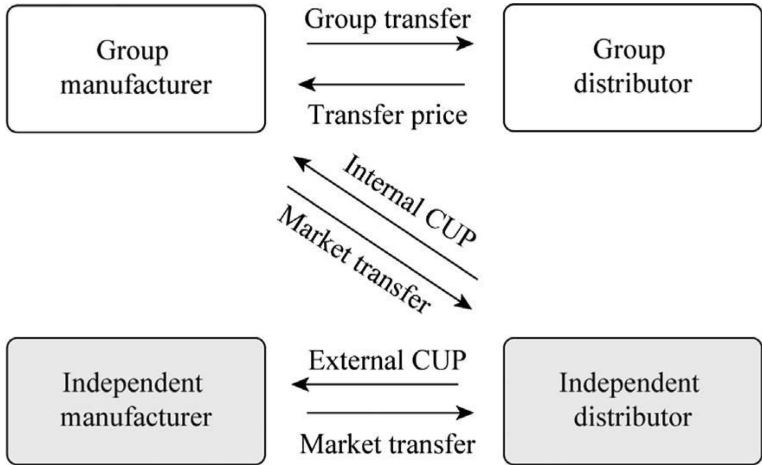


Figure 6: Comparable Uncontrolled Price (CUP) method (Plesner Rossing, C., Cools, M., & Rohde, C., 2017. International transfer pricing in multinational enterprises. Journal of Accounting Education, 39, 55-67).

2. Resale Price Method (RP)

Also known as the Resale Minus Method, the first step involves looking at the price that an MNE reseller (or distributor) charges to an independent customer not part of the MNE for a product or service bought from an associated enterprise (or manufacturer). The resale price represents the price of this transaction, in which the item is resold to the independent party. Next step consists of identifying the resale price margin, i.e. the amount of money required by the reseller in order to cover the costs of the associated selling and operating expenses. This also includes the quantity of money needed to make a fair profit, considering the functions performed by the party, e.g. assets used or risks assumed. It is determined by comparing the gross margins of comparable transactions made by unrelated organizations. After having identified it, this gross resale price margin is deducted from the resale price. Lastly, some fair adjustments are made, usually related to the purchase of the product, so expenses like custom duties for instance are deducted. The residual amount that remains is the arm's length price for the controlled transaction between affiliated entities. The RP method is a one-sided method since only the MNE reseller (the tested party) is examined, while the MNE supplier is completely disregarded in the determination of the transfer price. Clearly, for that reason, it is a method typically applied when the tested party (associated entity under analysis) is a distributor company. In addition, the RP method is not often used because the prerequisite needed to apply it is that third party transactions are comparable with the controlled transactions. This means that there cannot be differences between the two that cause a material effect on the resale price margin. So, it's difficult to meet such a requirement, due to the fact that every transaction is unique. But in presence of enough comparable data about the transactions, this method is recommended because sales prices of independent entities are easily findable.

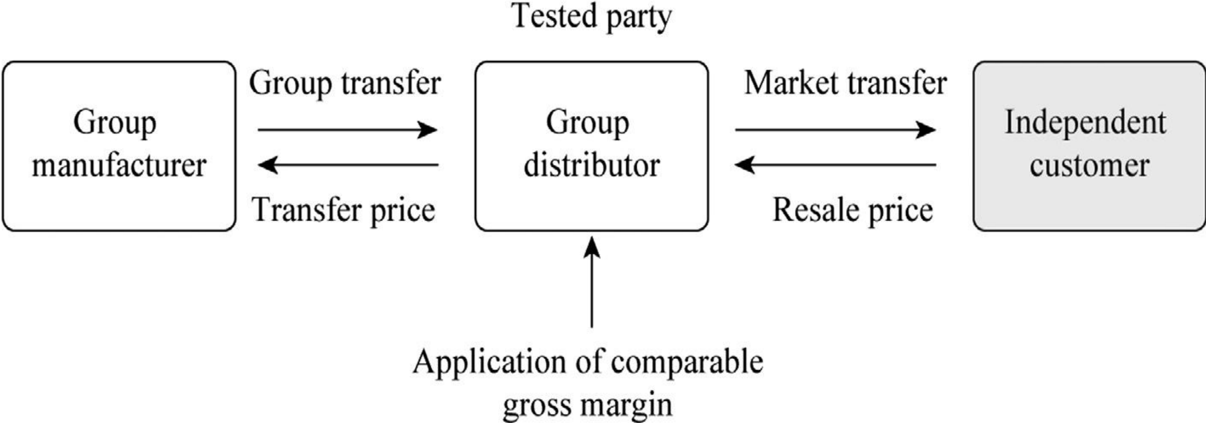


Figure 7: Resale Price (RP) method (Plesner Rossing, C., Cools, M., & Rohde, C., 2017. International transfer pricing in multinational enterprises. Journal of Accounting Education, 39, 55-67).

3. Cost Plus Method (CP)

At the gross margin level, this method represents an alternative for the RP method. In general, it compares the firm's gross profits to the cost of sales. The difference stands in the object of the focus: while the RP method focuses on the distributor, the CP method employs as the tested party the manufacturer (or supplier). First of all, the cost of goods sold, or CoGS, sustained by the manufacturer in a controlled transaction between associated entities is calculated. Secondly, a market-based markup for the product or service is added to this cost. This markup represents what can be defined as an appropriate profit for the supplier, considering the current conditions of the market and the functions performed. The appropriate markup is identified by looking at the markup applied in comparable transactions between unrelated or independent entities. The sum of the two quantities described constitutes the arm's length price for this type of transaction. The CP method is a one-sided approach as it is the RP one. Positive aspects of this method are that it is easy to understand and to implement, and it is very useful in the evaluation of transfer prices for low-risk activities (the manufacturing of tangible goods). Situations in which is usually implemented are controlled transactions of semi-finished goods or in which the two entities have reached a long-term agreement for "buy and supply". A limitation of this method, and in general of all the traditional transaction methods, is the availability of comparable data necessary to carry out this procedure, and consequently, the high degree of comparability both controlled and uncontrolled transactions require. Finding reliable information about comparable transactions between independent enterprises is not easy and requires a great effort of time and resources. Examples of detailed information that should be available are cost structures, products manufactured, or services offered, actual activities and

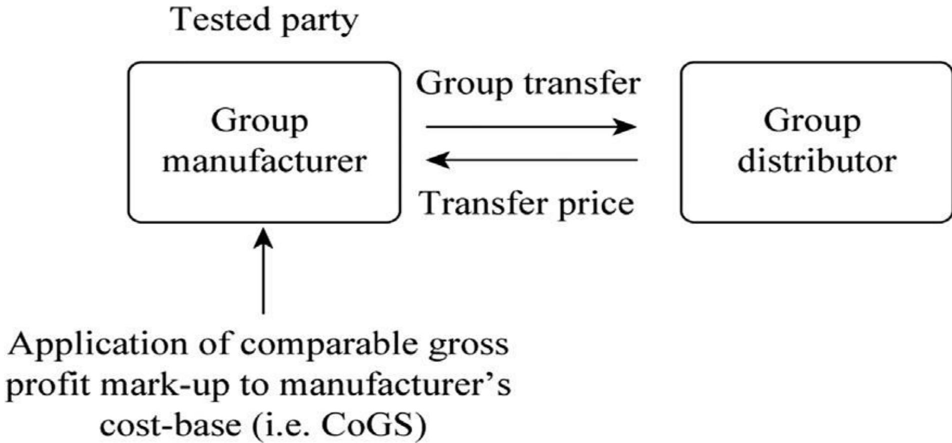


Figure 8: Cost Plus (CP) method (Plesner Rossing, C., Cools, M., & Rohde, C., 2017. International transfer pricing in multinational enterprises. Journal of Accounting Education, 39, 55-67).

also the use of intangible assets. Without this information, it is hard the CP method will be implemented.

→ Transactional Profit Methods

When there is no information available about the gross margin earned in comparable transactions for the application of the RP or the CP method, other two methods focusing on net margins are implemented.

4. Transactional Net Margin Method (TNMM)

According to this method, the net profit of a controlled transaction is determined. This value is estimated using an appropriate base, that can be represented by and typically consists of full costs, so CoGS plus Selling, General and Administrative costs (SG&A), when the method is applied to manufacturers; external sales when applied to distributors; and in other cases also assets employed, all resulting from a controlled transaction. The ratio of the net margin relative to the base (costs, sales, assets) is called the net profit indicator and is the key element of this method. According to OECD, it should be the same of the one that would be applied by the taxpayer in comparable uncontrolled transactions. After this calculation, the net margin is compared to the net profit of a comparable uncontrolled transaction between independent enterprises and the arm's length price is determined for the transaction.

There are two types of comparable uncontrolled transaction: the first happens between an associated company and an independent one (internal comparable); the second is between two independent enterprises (external comparable).

Transactions taken into consideration are required to be broadly similar in order to be defined as comparable. It means that the compared transactions don't have to be precisely like the controlled transaction, but only very much alike. For that reason, the applicability range of this method increases. In fact, the TNMM is very used by MNEs and is easy to implement since it just requires financial data. It is powerful and efficient, for example, for product manufacturers with simple transactions, because it is not complicated to find comparable data necessary for the comparison.

The TNMM is the most used transfer pricing method owing to the various forms of net profit indicator that can be used and consequently to the wide applicability it possesses. This latter can range from low-risk routine manufacturing and services to more complex activities as sales

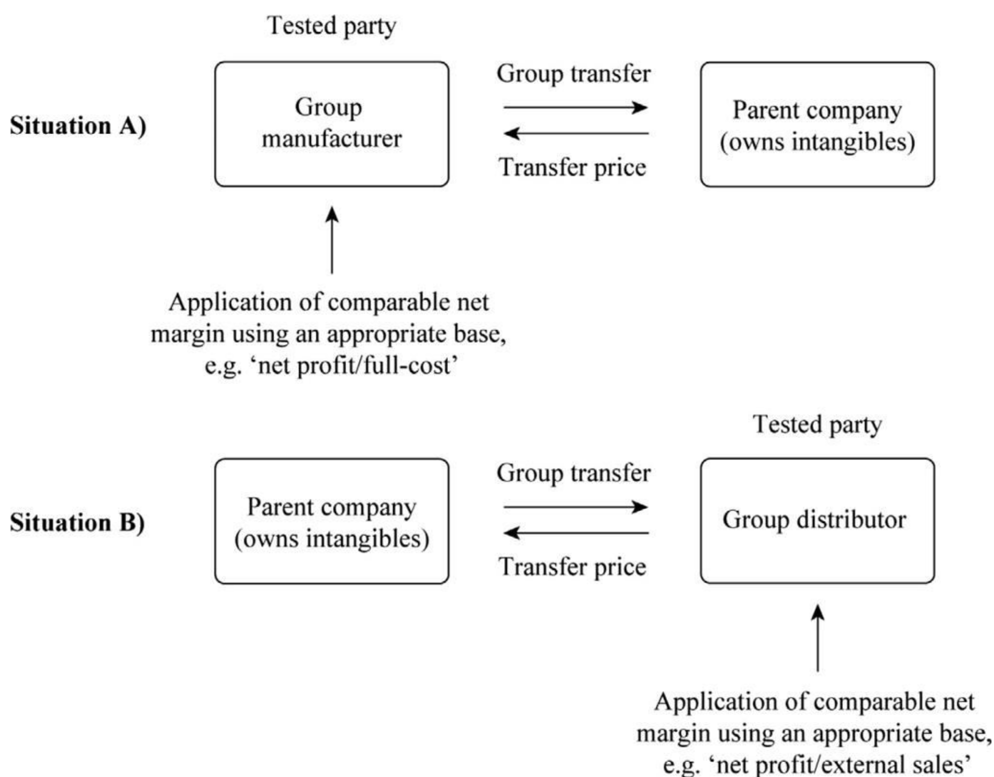


Figure 9: Transactional Net Margin Method (TNMM). (Plesner Rossing, C., Cools, M., Rohde, C., 2017. International transfer pricing in multinational enterprises. Journal of Accounting Education, 39, 55-67).

and distribution. One possible drawback is represented by the questionability of the level of comparability of uncontrolled transactions, but this is exactly the reason why the TNMM is used in place of the other methods that cannot be implemented because of a lack of information and comparability in general.

5. Profit Split Method (PS)

The last method outlined by OECD is applied to mutually dependent (or intra-group) transactions, from which the total net profit generated is calculated. The peculiarity of the PS method is that it does not use any reference to specific comparable market conditions, as in the other methods. Once the total profit is estimated by combining the profits of the related parties, it is split and allocated between the parties involved in the transactions, according to their contribution in the creation of value to the transaction. The allocation is usually determined by an economically justified basis involving the two entities.

When the profit is split to being allocated to the group companies, a comparison is made with the net profit margin expected to be realized by independent parties engaging in a similar transaction, taking into consideration the functions performed, the risks assumed and the assets owned by each entity of the intra-group transaction. There exist two approaches to split profits:

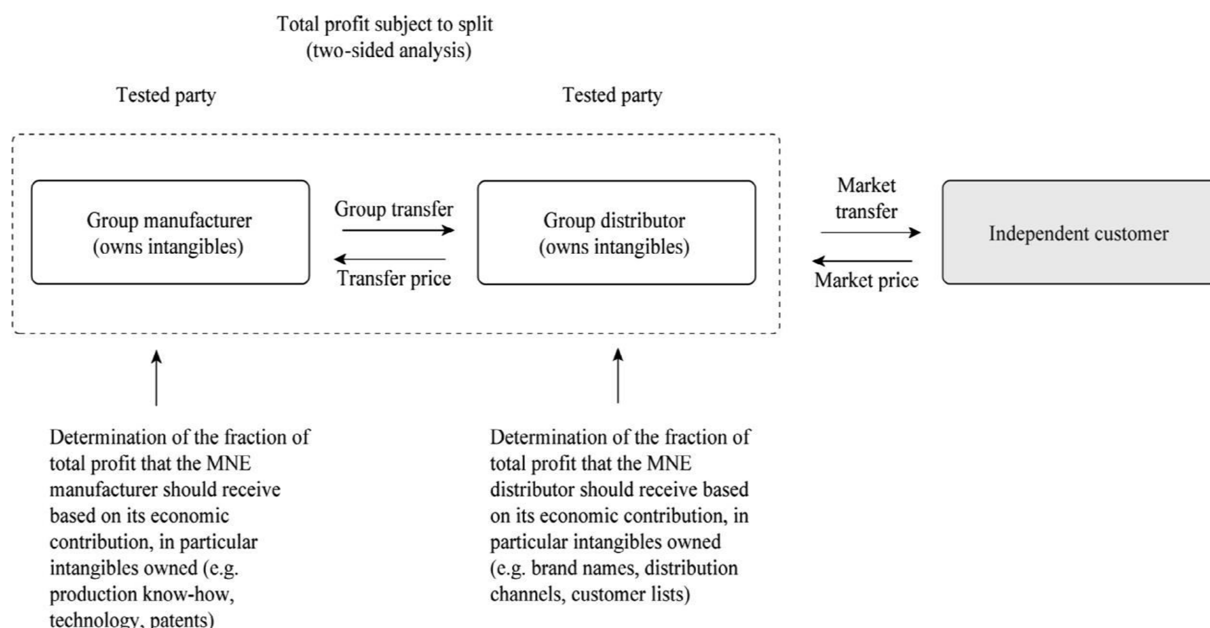


Figure 10: Profit Split (PS) method (Plesner Rossing, C., Cools, M., & Rohde, C., 2017. International transfer pricing in multinational enterprises. Journal of Accounting Education, 39, 55-67).

the first one is the contribution analysis, according to which the profits are split carefully considering the functions performed by the intra-group companies in the controlled transaction. Moreover, necessary for this process to succeed is the measurement of the allocation of costs, earnings, expenses and capital of the two entities involved. The second one is the residual analysis, which includes two steps. First, it consists of allocating the right compensation to the two entities always considering the functions and the contribution to the transaction, what is called the routine profit for an entity. Then, any remaining profit is distributed after an analysis of the facts, circumstances and context of the transaction.

It is particularly useful when managing intangible assets (IP or brands) and in presence of simultaneous controlled transactions, or also where the controlled transaction is highly integrated, such as in the institution of a partnership or the shared exploitation of intangible assets. Despite this, the PS method is not given the same priority as the other methods, because of the subjectivity of the profit allocation criteria used, that involves more risks of not operating with the arm's length principle and, as a consequence, the possibility of entering disputes with tax authorities or institutions.

The following table summarizes the most important characteristics of the 5 methods.

METHOD	OBJECT OF COMPARISON	SUITABILITY	STRENGTHS	WEAKNESSES
Comparable Uncontrolled Price (CUP)	Price of transaction	In presence of a significant amount of data; financial transactions (group loans); determination of prices of intellectual property (IP).	Reliable, direct and effective; OECD preferred method.	Need of a lot of comparables data; reliable information on external CUP difficult to find; high standards of comparability met by the uncontrolled transaction.
Resale Price Method (RP)	Gross Profit Margin	When the tested party is a distributor company; little value addition in the sales to the unrelated party.	Sales prices of independent entities are easily found.	One-sided method (only the reseller is examined); accounting inconsistencies may affect the analysis.
Cost Plus Method (CP)	Gross Profit Margin (on direct or indirect cost)	Controlled transactions of semi-finished goods or in which the two entities have reached a long-term agreement for "buy and supply".	Easy to understand and implement; useful in the evaluation of transfer prices for low-risk activities (the manufacturing of tangible goods).	Availability of comparable data; high degree of comparability required; reliable information on comparable gross margins earned by independent parties are not easy to find.
Transactional Net Margin Method (TNMM)	Net Profit Margin	From low-risk routine manufacturing and services to more complex activities as sales and distribution.	Easy to implement because it requires only financial data; net margins are less affected by product differences, accounting inconsistencies and functional differences; variety of net profit	Questionability of the level of comparability of uncontrolled transactions; Net margins can be influenced by factors that do not have an effect, on price or gross margins.

			indicators and wide applicability.	
Profit Split Method (PS)	Contribution of the entities	Mainly used by joint ventures; to manage intangible assets (IP or brands) and in presence of simultaneous controlled transactions, or where the controlled transaction is highly integrated, such as in the institution of a partnership or the shared exploitation of intangible assets.	Two-sided analysis; remote possibility for both entities of being left with an improbable profit result.	Subjectivity of the profit allocation criteria; more risks of not operating with the arm's length principle; possibility of entering disputes with tax authorities or institutions.

Table 2: Characteristics of the 5 transfer pricing methods outlined by the OECD (Our own elaboration).

2.3 Transfer Pricing Documentation

Another important step in the transfer pricing process is the submission of the required documentation demonstrating that the arm's length standard is implemented in the establishment of the transfer price. It has three main objectives:

- To ensure the respect by taxpayers of transfer pricing requirements when establishing prices or other conditions for controlled transactions and when reporting in the tax returns the income coming from these transactions.
- To provide the information to tax administrations to conduct a transfer pricing risk evaluation.
- To provide tax administrations with appropriate and proper data about the transfer pricing practices of a company, in case of an audit.

In order to address the purposes of increasing transparency and standardizing the documentation, three documents are required to be prepared: the master file, the local file and the country-by-country report.

The master file provides a general overview of the group's transfer pricing by including high-level information about operations and policies adopted. Examples of information are the geographic locations of the operations, the organizational structure of the group, the descriptions of products and services, the main profit drivers, and so on. The master file has to be compiled by the parent company, and not by every subsidiary, although it needs to be accessible to local tax authorities. It usually present itself as a document with a number of written pages that varies depending on the company.

The local file contains detailed information on the local entity's intragroup transactions. Its preparation is specific to each country in which the group is present and active, and serves as an authentication of the business unit's activities in a particular jurisdiction. Examples of information included in this file are the intragroup transactions performed during the tax year, the management structure of the various units, the related intercompany agreements, transfer pricing method and application, and so on. A focal point is to guarantee consistency between the information of the local file and the master file, to avoid discrepancies that can lead to audit risks. The form of the local file is the same of the master file.

CbC template – Page 1

Country	Revenue			Profit (loss) before income tax	Income tax paid (on a cash basis)	Income tax accrued – current year	Stated capital and accumulated earnings	Number of employees	Tangible assets other than cash and cash equivalents
	Related party	Unrelated party	Total						

CbC template – Page 2

			Activities										
Country	Constituent entities resident in the country	Country of organisation or incorporation if different from country of residence	R&D	Purchasing and procurement	Manufacturing and production	Sales, marketing and distribution	Administrative, management and support services	External service business	Regulated financial services	Insurance	Holding company	Dormant	Other

Figure 11: The format of the CbC reporting template as provided in BEPS Action Plan 13 (KPMG, 2016. BEPS Action Plan 13).

The country-by country report (CbC) is a summary of the activities of all the group's related entities performing transactions within the jurisdiction (Figure 11). The information needed to compile it are taken from the master and local files.

This chapter tried to present, describe and explain the dynamics behind the procedures and advice proposed by the OECD in its Guidelines. The five transfer pricing methods are generally accepted by almost all tax authorities. Clearly, there exist other transfer pricing methods around the world that are more or less similar to these ones. It is evident that they are widely implemented by most MNEs, although they are not binding or mandatory for any company. They include three traditional transaction methods, the CUP, the RP and the CP methods, and two transactional profit methods, the TNMM and the PS method. What is important to state is that it doesn't exist a right or wrong method for every firm or situation, but the choice of a determined method is subjective and it depends on several factors that must be deeply analysed and evaluated in order to make the best selection for the group as a whole. These features comprehend the availability and quantity of relevant comparables data, the level of comparability between the controlled and uncontrolled transactions, and checking if a method is suitable for a particular transaction and its nature (for this last point the functional analysis is crucial).

CHAPTER 3

Methodology

After having introduced the topic with an historic overview of the most important articles and papers published, it is now the moment to examine the two case studies of Marchesi and Eclisse. The information about the two companies comes from a reformulation of the answers given to a questionnaire submitted to the concerned competent persons in the two firms.

The questionnaire (see Appendix), the method used to obtain information, is divided into 4 sections: the first two focus on personal information about the interviewee and demographic information about the company concerned, the third concerns the cost accounting system and product pricing, and the fourth relates to the main topic of the study, namely transfer pricing information. The questions have different origins, based on the related specific subtopic. The first two sections contain basic questions useful to open the interview and to have a general knowledge of the respondent and the context around him/her. For the third and fourth section instead, previous studies resulted indispensable for the definition of the inquiries. Indeed, a university course named "Advanced International Accounting" represented the source of inspiration for the formulation of most of the questions of section 3 and 4 of the questionnaire. In particular, topics like the costing method, the assignment of costs to products, the allocation of overhead costs and product pricing were central in the teaching of this subject. Regarding transfer pricing, most of the questions have been thought about after having read literature articles about the topic and its nuances. The first question opens the section by shedding light on the differences between countries on transfer pricing regulations. The sixth question was formulated after the reading of the article "A longitudinal study of the determinants of transfer pricing change" by Boyns, Edwards and Emmanuel of 1999, in which the authors sustained "that the historical background and evolution of the firm are significant factors that cannot be ignored in the study of transfer pricing change". Fundamental in the production of the seventh question was the paper "Determinants and consequences of transfer pricing autonomy: an empirical investigation" by Chen, Chen, Pan and Wang of 2015, because of the attempts to explain how much authority to give to subsidiaries. The idea for the eighth question comes from the articles of Jordan (1990) and Vaysman (1996), both concentrated on divisional financial performance and its measurement by the firm's headquarters. Notions like goal congruence and information asymmetry were addressed by almost all academics during the years, because of its importance in the subject of transfer pricing; these are part of the ninth question, together

with the assessment of the performance. The tenth question is about a recurrent matter in literature, quoted and studied by Baldenius, Melumad and Reichelstein (2004); Martini (2015); Plesner Rossing, Cools and Rohde (2017); Klassen, Lisowsky and Mescall (2017). Source of stimulation for question number eleven was Borkowski (1992), who inserted in her framework the idea of innovation and its measurement. The twelfth question is the result of the reading of many articles about the double face of transfer pricing, useful to understand the inclination and tendency of the two companies towards one or the other aspect. Kumar, Pandey, Lim, Chatterjee and Pandey (2021) focused on the dualism between the strategic nature and tax compliance of transfer pricing, from which the 14th question took shape. Articles dedicated to the matter of tax compliance and avoidance represented the source for the last question about possible conflict or debates with OECD or other institutions. Among the quotable articles dealing with that there are Sikka and Willmott (2010), Shantanu (2012) and Cools (2014).

The form presents itself as a qualitative research, trying to extract data that describe the argument rather than measure it with quantitative data. So, in the first place, it deals with knowledge and preparation about the topic, but it involves also opinions, points of view, impressions and advice more related to the human sphere that help interpreting numbers or objective tendencies of the results.

The decision to propose a qualitative research instead of a quantitative one lays in the fact that the information needed is not numbers or figures, but an explanation about the dynamics, the changes, the evolution, the rules and laws to follow and respect depending on the context and circumstances that are analysed. Normally, this sort of inquiry is less structured and seeks to go deep in the argument in order to collect information about motivations, attitudes and thoughts of people.

Although qualitative research can run the risk of being too vague or unclear, the proposed questionnaire is made up of questions that are particularly directed to the specific point or information they want to extrapolate. This in-depth procedure has taken a considerable amount of time, more or less 2 hours for each respondent.

The main goal of this interviews is to extract data about the transfer pricing system implemented by each company, the dynamics characterising it, the relationship between the headquarters (HQs) and the subsidiaries or divisions of the groups. Particular attention is given to the relation between the parent company and the Romanian subsidiary, since both Marchesi and Eclisse have commercial and trade relations with this eastern European country.

The purpose is to analyse the aforementioned relationship, examine the method used by both companies and figure out what are the differences and why they exist, although the two firms belong to different industries.

CHAPTER 4

The Marchesi Group Srl

The first case study we are going to analyse is the one of Marchesi Group. Before going into deep with the topic of transfer pricing related to the group, an introduction and a presentation of the company are made, in order to be aware of the features that characterize it, such as its worldwide location, products and structure, just to name a few.

Figure 12: The logo of Marchesi Group (Marchesi Group website, http://www.marchesi.com/).

4.1 History of the company

In 1946 Alessio and his son Rodolfo Marchesi founded the company with the name "Fonderia Alessio Marchesi" with the purpose of processing no ferrous alloys and producing articles for households. After nine years, in 1955, it started the production of accessories for doors and windows, making this the core business of the company until the seventies. From the early years the company is present on the international market, selling its products abroad. In 1961 the first part of the current Italian factory of 4000 square meters is built, including the new foundry, tumbling, turning, grinding and finishing departments, as well as offices, exhibition room and warehouses. The company has 2 founders and 3 employees. A great step is made in 1966, when it entered the telecommunication equipment industry expanding the market in Northern Europe, particularly in Germany; first with the fix line equipment and then, with the evolution of the technology, in the wireless communications. In the '70 the company became a share limited company, changing its name to "Fonderia Marchesi Spa" and moving into the current site and became an international supplier of multinational corporations. At the end of the 90s the production cycle was integrated with the phases of chromating, painting and other surface finishes, assembly and gasket application. A progress for the presence in foreign markets dated back to 2005, year in which the group expanded the manufacturing in China, opening the first site in Suzhou, P.R., which was dedicated to aluminium die-casting for base stations and other telecom equipment. Two years after, the Chinese firm broadened its know-how thanks to the installation of magnesium die-casting capability for telecom and power tool components. Other two advancements were made in 2008 and 2009, respectively with the completed acquisition of CNC (Computerized Numerical Control) machining company to bring in house precision

machining capacity, and with the expansion in the country of the R&D activities of the group for the development of innovative products and processes in the industry. In 2013 it expanded to a four times larger new site with the internalization of most of the phases of the production cycle, such as die-casting, CNC machining, assembly and gasket application. The international outlook of Marchesi Group grew thanks to the opening of two new facilities: in 2015 the one in Romania to cover European markets, a year after an investment made for a manufacturing expansion in the eastern Europe country, and in 2016 the one in Mexico to serve North American markets, specifically engaged in aluminium die-casting, CNC precision machining and surface treatment. In the same year of the Mexican firm foundation, the chrome plating and painting lines were introduced in the Chinese plant. A year after, in 2017, the Romanian one moved to a new 5000 square meters building, specializing in the installation of copper and silver-plating process.

4.2 Vision, strategy and management system

The vision of Marchesi Group is to find synergy between the company, the clients and the suppliers, planning the future by following the principle that "any problem of our client is our own problem" and consequently behaving with a "first solve and then ask" attitude. In order to reach this vision, the group emphasizes on strong and long-term relations with trading partners, the global presence (Asia, America and Europe), the continuous research for new technological and product solutions, the sustainability of the production, the automation of productions processes, the constant attention to market changes, the group-level process standardisation and business continuity guarantee, quality products at competitive costs, and constant and targeted training. The mission is to be the quality and technology front-end leading manufacturer of mechanical components for global telecom and electronic equipment makers. The group has established itself and aims to remain the leader in technological innovation in the die-casting for telecom equipment fields with a global footprint. Marchesi also believes that all its people must "Love what you do". This is the reason why the first demand and expectation for a great contributor to his/her company, family and the whole society is to work with pleasure and so to work with the heart in his/her actions. Regarding the quality management system, the driving force behind it is the desire to maintain and improved its reputation, its customers satisfaction and the overall quality of the products and services. The company believes in the team as a motive power, but only if every individuality is enhanced, because everyone's contribution represents a great value for the others. Dealing with social responsibility, Marchesi wants to create a working environment with a high level of safety, human health and environmental

protection. The group is committed to introduce the best practices in production processes that go beyond the application of current regulations. The continuous improvement of the regulations and behaviour of its employees and collaborators aims to minimize the risk of dangerous and harmful situations for people and the environment.

4.3 Global Footprint

Marchesi Group is present in three different continents with four companies in Italy, Romania, China and Mexico, because of the presence of new trends of more distributed manufacturing operations of its multinational clients requiring the capability of producing and delivering in the proximity of the place of assembly.

- ➔ Italy

The Italian company is called Fonderia Marchesi Spa and is located in Tione di Trento in the northeast of Italy. The manufacturing site is located at the heart of Adamello Brenta Nature Park in the western part of Trentino Province. It is endowed with 80 lakes and with the Adamello Glacier, one of the largest glaciers in Europe. Its fauna is among the richest of the Alps and includes all animal species which find their habitat on the mountains. Marchesi is fully dedicated to the protection of the rich woods and meadows, fruits and flowers which are rare to find, thousands of insects, birds and other animals whose life is determinant for the biological equilibria of the Park and of the earth.

- ➔ Romania

Marchesi Eastern Europe Srl is a factory located in Caransebes, near Timisoara, on the gateway to Bucharest in the southwestern side of Romania. This area has been historically linked to mechanical processing and is providing quite numerous workforces, highly qualified, at low costs, of all preparation grades; thanks to an environment with a reduced grade of pollution and equipped with all the necessary public services such as water supply, sewerage, flood protection, electric energy and natural gas supply, and to a cutting-edge telecom network including the optical fibres, this area is experiencing a new development.

- ➔ China

The Chinese factory called Marchesi Metal Tech.(Suzhou)Co.,LTD. is located in "China-Singapore Suzhou Industrial Park" (SIP), in the eastern suburb of the Suzhou city, and eighty kilometres away from Shanghai. SIP lies in the centre of the Yangtze River Delta and the juncture of China's coastal economic open areas and the Yangtze River economic development

belt. SIP is a modern, integrated complex with comprehensive development for industry, commerce and residence as well as infrastructure and social facilities; in a Singapore-styled environment which provides all the advantages of a national-level industrial park.

➔ Mexico

The new company of Marchesi Group, Marchesi Manufacturing Mexico Srl de C.V., locates into a 15.000 square meters facility in the south of Guadalajara, whose metropolitan area is the second largest in Mexico with its over four million population; therefore, there is a large basin of technicians and labour.

4.4 Sectors and manufacturing

Marchesi belongs to a capital-intensive industry and is leader in technological innovation in the die-casting for telecom equipment fields by the commitment to drive R&D, technology, processes, products and services with new way of thinking and ideas.

The company is present in a great variety of sectors, ranging from the telecom and automotive to lighting and articles for households.

Telecom represents the core business of Marchesi production, having gone through all the transformations of the industry and its development, from the fix line phones working for Marconi to the TACs mobile, GSM generation, WiMAX and UMTS, 3G and 4G and is currently engaged in the development of parts and prototypes for the 5G new generation machines. While Marchesi is still engaged our days in producing parts for fix line communications, more and more important are the components for the backhaul and microwaves with high frequencies demands, therefore mechanically more challenging.

Another sector which can be defined as a core business for the group is the mechatronics & automation one, thanks to the development, production and sale of millions of manufacturing part and components. Many electronic applications are combined with mechanical parts to obtain a wide range of functions, from protection and casing to heat-dissipation or electrical conductivity to lightness, from resistance to vibrations or to weather elements to many more.

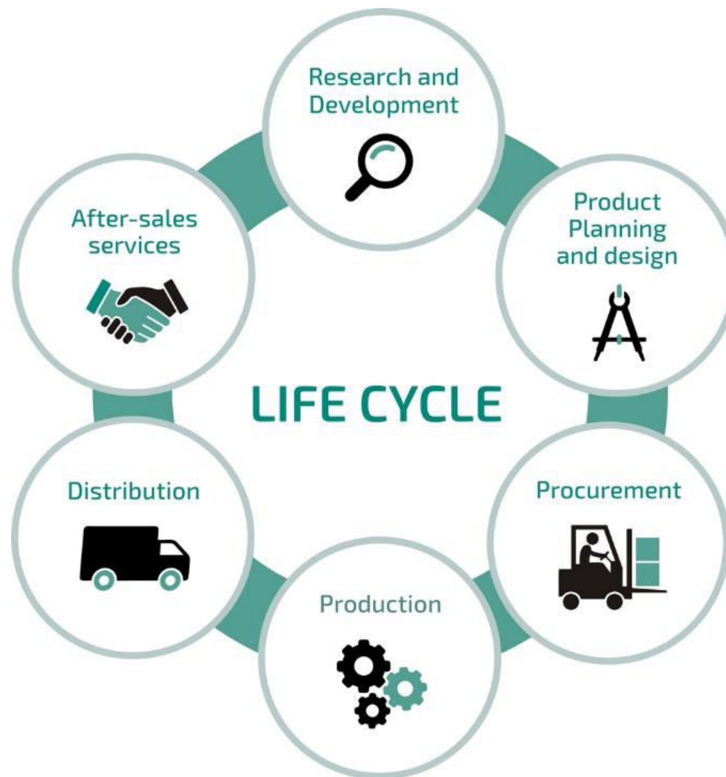


Figure 13: A product life cycle (Marchesi Group website, http://www.marchesi.com/).

Owing to over ten years of manufacturing of components in aluminium and magnesium for machines of the major players in the field (Stihl, Hilti, Husqvarna, etc.), Marchesi has acquired a deep understanding of power tools' sector, and in particular of the needs in terms of high volume and high precision demand (gear-housing) production both during casting stage (0.005 microns) on the production of millions of parts as well as for the precision machining stage (0.002 microns).

A new and still little explored area is the automotive one, which represents a new field of engagement for Marchesi, with a particular focus on the Eastern Europe and North America operations.

With the evolution of the industry toward the production of LED-lighting with needs of heat-dissipation, Marchesi has been more and more involved in the field of lighting for its capacity of engineering and co-design as well as industrializing and producing high-design, high-efficiency and high-to-middle volume parts.

The experience of Marchesi is strong in the field of instrumentations such as pressure meters, valves, electronic scales and a wide range of machines with high precision demands and/or leak demands, suitable to be employed for measuring liquid or gases of physic quantities.

The sector of pneumatic and hydraulic has been successfully entered by Marchesi where the demands of high-working pressure for oil-based mechanism with safety concerns involved the requirement of an extremely competent, quality qualified manufactured of such components (as example can be mentioned parts for forklifts, car-lift bridges, elevators parts, etc.).

The last field Marchesi is involved in is the one of articles for households. The group has been engaged with major players in the field in the development and production of parts for machines; the production is normally featured by low volume and high-mix parts with high-quality requirements in terms of mechanical properties and precision.

Going more into detail, a great number of manufacturing activities necessary for the creation of products can be enumerated.

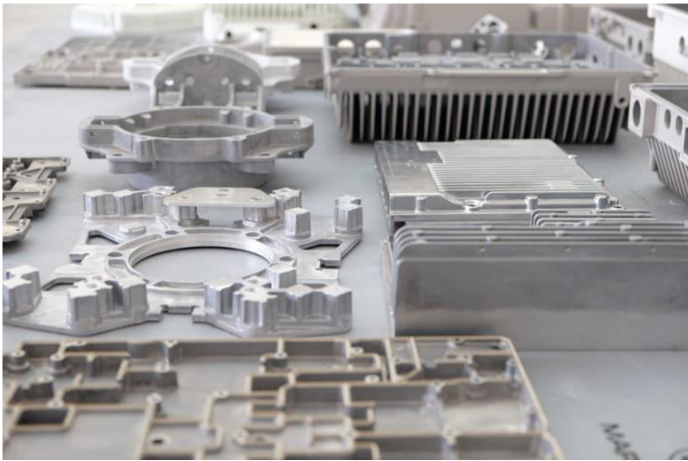


Figure 14: Results of aluminium die-casting (Marchesi Group website, http://www.marchesi.com/).

Die-casting, the process through which molten metal is forced into a mould cavity using high pressure, is probably the cornerstone of the company, that deploys automatic cold chamber die-casting machines ranging from 400 ton to 1900 ton dedicated to aluminium and magnesium alloy. The aluminium casting market (Figure 14) in particular comprises different die-casting processes and it is a business characterized by wide span of final applications, such as automotive, aerospace and defence, telecommunication, power and hand tools, building and construction hardware, heavy industrial machinery. Besides, there is also brass die-casting, for the production of handles or doorknobs.

Figure 15: A CNC machine in action (Marchesi Group website, http://www.marchesi.com/).

Regarding CNC machineries (Figure 15) for cast, extrusion and solid parts, Marchesi has an advanced ability in their implementation, with high machining precision and advanced process quality control, which can meet customer's

processing requirement from the simplest one to the most complicated and challenging. The horizontal CNC centres allow the company to maintain a very high level of precision on high volumes.

With professional design engineering and modernized machining technology, Marchesi can design and manufacture all kinds of complicated moulds for customers, including soft moulding solutions for rapid prototyping and developed high efficiency CNC machining fixtures.

Chromating involves the treatments related to the chemical conversion of the casting surfaces in order to obtain their enhanced corrosion resistance performance while preserving a suitable electrical conductivity. This process can be offered both on aluminium and magnesium substrate, using made-in-Italy lines based on circulation of the water and in compliance with the local environment regulation. Moreover, the company controls in house the corrosion resistance performance with fog test chambers and also the conductivity functions with tailored made equipment.

Another activity in which Marchesi has a long experience and professional expertise is powder painting. This can be applied on both aluminium and magnesium components requiring an high aesthetic functionality as well as an enhanced level of corrosion protection due to the possibility of being employed outdoor. In its completely automatic and environment compliant lines, Marchesi can process a wide range of epoxy, polyester or polyurethane powder coatings with any colour or thickness, or gloss requirement demanded by specifications of the clients. The laboratories perform a wide range of in-process testing, such as the control of the colour variance, adhesion, impact, flexibility, layer thickness measurement and the corrosion resistance test.

Not least, the galvanic electro-plating (Figure 16) is directly engaged in the regions where the supply chain is not sufficiently competitive and strong, and in relation to the production of telecommunication components, so in services for copper, silver and electro-less nickel strikes. The group offers a complete solution for magnesium die-

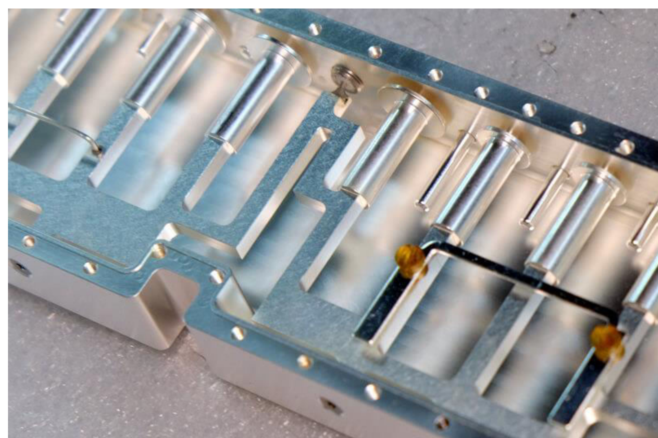


Figure 16: Components resulting from the galvanic electro-plating (Marchesi Group website, http://www.marchesi.com/).

casting copper or silver-plated parts for large quantities in mass production.

Another task performed by Marchesi is gasket application, including both form-in-place (FIP) gasket deposition and thermal gasket application. Two or three -axis CNC dispensing robots are utilized to assure gasket repeatability and accuracy.

Considering services to support customers, the company is present from the initial stage, caring for what customer think, establishing solutions of product-related works to meet customers' needs for product development and manufacturing on the basis of the understanding of customers' need for products. Marchesi brings in various series of test equipment like admeasuring apparatus, press machine, power balancing apparatus, experienced test engineers, and perfect and advanced test system, so as to fully upgrade the quality standard of products. The group is able to deliver zero-defect competitive products and services to customers on time, thanks to modern standard assembly lines.

The last mansion is worth mentioning is the quality control system to meet clients' requirements, supported by the maintenance of a high standard quality system, the training of the personnel and the deployment of state-of-art measuring equipment, such as the heavy-duty impact tester or the hardness, height and roughness meters, just to name a few.

4.5 Transfer pricing

Before going into deep with transfer pricing, some indications and information must be given about the respondent, the company in general and the accounting system of the company.

All the following information come from the interview with Eleonora Marchesi, internal audit for Marchesi Group and accounting and finance manager at the Italian level, so for Fonderia Marchesi Srl and Marfin Spa[6]. She's part of the company since the 25th of November of 2013, but officially responsible for this specific sector since 2017, and her current job level belongs to the middle management. She works in the headquarters of the group in Tione di Trento, but she's not part of the holding management board.

Partners of Marchesi Group are Roberto and Giorgio Marchesi, with half of the shares each. The holding company is made up of 4 people, while in the Italian company Fonderia Marchesi Srl 52 people are employed. The group operates in a business-to-business (B2B) context, so making transactions with other companies, groups or multinational enterprises, and not selling

[6] Marfin Spa is the holding company that entirely controls both the Italian and the Romanian companies, Fonderia Marchesi Srl and Marchesi Eastern Europe Srl.

directly to private clients. Last year group's turnover was around 28 million euros, remaining stable over the last three years.

The company has a functional organizational structure, divided into departments based on the specialization of its workforce. Responsible for the internal accounting are two persons, one graduated in Finance and the other certified accountant.

Specifically regarding cost accounting, the firm adopted the process costing for the detection and allocation of costs, in particular per phases, thanks to continuously updated standard costs. Full costs are made up of costs taken from the bill of materials and production cycles, so the cost of materials and direct and indirect labour (internal or external) costs, plus costs derived from product stock management, including general expenses, cost of quality, , the support to the productive process, the technical office and the sales one. In the allocation of costs to products, despite the fact that it cannot be used in financial reporting, Marchesi Group opted for the variable costing methodology, according to which the fixed manufacturing overhead costs are excluded from the product cost of production. So, included in the cost of goods sold (COGS) are the variable, direct costs, while the fixed direct costs are allocated to operating expenses. The reasons behind the choice of this method are the possibility to conduct a break-even analysis to determine how many units have to be sold to begin earning a profit; the determination of the contribution margin on a product to analyse the relationship between cost, volume and profit; the facilitation in decision-making due to the exclusion of the fixed manufacturing overhead costs, which sometimes can create some problems in relation to their allocation.

Dealing with allocation of costs to products, there are several types of costs to consider: the ones related to the purchase of materials relating to the bill of materials, the utilities assigned to machineries or production lines, indirect costs as the depreciation of machineries, transversal costs as the ones related to environment and safety. To all these, overhead costs, such as insurance, maintenance, consumables and IMIS (a direct local property tax in force only in the municipalities of Trentino) are added, after having been defined in a direct and proportional way as a ratio of the total of the costs. The percentage obtained, usually ranging from 6% to 10% (last year it was 6,24%), is then applied to the industrial cost, to get to the final cost.

Regarding product pricing, the two main factors to consider are clearly target profit, without whom there wouldn't be a revenue, and the customer demand, with an overall assessment of the client in order to define the exact price. This evaluation involves the check of the total

turnover, also taking into account the range of products, because wider it is and more Marchesi is willing to offer discounts on its products and services. Another feature is differentiation because Marchesi operates in multiple industries and as a consequence it prefers and favours the ones with higher product volumes per codes. An aspect in which there is not so much interest is product life cycles, because generally they range from 5 to 7 years. Dealing instead with the method adopted to price final products, the group chose the cost-plus method, in which the price is made up of the full cost plus a margin or markup, which represents the desired profit the group wants to earn for the product sold, but also for providing a contribution to non-assigned costs.

After this brief introduction to the procedures adopted by the group, transfer pricing dynamics between the Italian company and the Romanian subsidiary can be analysed in detail. To begin, light must be shed on the laws and regulations governing transfer pricing transactions both in Italy and in Romania. PricewaterhouseCoopers (PwC) published in 2015 an easy-to-use reference guide entitled “International Transfer Pricing 2015/2016”, in which a range of transfer pricing issues in nearly 100 territories worldwide are covered. Starting with Italy, the Italian Tax Authority (ITA) accepted all the OECD methods, pointing out that the comparable uncontrolled price (CUP) method and the other two traditional ones (RP and CP) have to be preferred. The topic of transfer pricing has gained increasing attention in recent years in this country. The reason behind that is an ongoing relocation of manufacturing outside of Italy to countries with low production costs, tax incentives, developed infrastructure and a skilled labour force as a response to the high competition. Dealing with audit procedures, there are dedicated units working exclusively on transfer pricing, and as a consequence the number of audits has increased in recent years. These inspections are performed by qualified personnel, with an improved level of preparation and technical support always available to solve possible problems. In 2010, the year in which Italy recognized the OECD Guidelines, penalty protection documentation rules were introduced together with them. To date, Italy requires reporting of

Country	Romania
OECD member?	No
TP legislation	
Are there statutory TP documentation requirements in place?	Yes
Does TP legislation adopt the OECD Guidelines?	Yes
Does TP legislation apply to cross-border inter-company transactions?	Yes
Does TP legislation apply to domestic inter-company transactions?	Yes

Table 2: Romanian Transfer Price Legislation (PwC, 2015. International Transfer Pricing 2015/2016).

all inter-company transactions in the annual tax return. These developments contributed significantly to the enhancement of the profile of transfer pricing in Italy, with an increasing awareness and general interest. In addition, the topic of transfer pricing has become central for the Italian tax authorities, turning into one of their key audit and tax adjustment areas. The audits generally are carried out on the taxpayer's premises. The ordinary procedure takes place without having been announced in advance, but sometimes tax authorities can send a formal request for information.

Regarding Romania, the trend in transfer pricing developments reveals a growing interest of tax authorities towards this topic, which represents one of the main areas of tax investigation. Consequently, MNEs pay more attention to the arm's length of their transactions and the annexed documentation to present, in order to be prepared in case of audit activity or disputes with tax authorities. Although is not an OECD member, Romania decided to adopt the OECD Guidelines (as we can see from Table 2), requiring transactions between related parties to be performed at the market value. If the arm's length principle is not followed, Romanian tax authorities can adjust the taxpayer's revenue and expenses so it can reflect market value. Even if the basic concepts are the same, as they are both part of the European union, some differences between Romanian and Italian legislations concerning transfer pricing can be found, in particular dealing with documentation and penalties. While transfer pricing documentation in Italy provide penalty protection, this is not the same for Romania (as we can see from Table 3). Moreover, the documentation must be prepared only at the request of Romanian tax authorities,

Country	Romania
Does TP legislation adhere to the arm's-length principle?	Yes
TP documentation	
Can TP documentation provide penalty protection?	No
When must TP documentation be prepared?	At the request of Romanian tax authorities
Must TP documentation be prepared in the official/local language?	Yes
Are related-party transactions required to be disclosed on the tax return?	No
Penalties	
Are there fines for not complying with TP documentation requirements?	Yes
Do penalties or fines or both apply to branches of foreign companies?	Yes
How are penalties calculated?	As a percentage of the adjustment to taxable income

Table 3: Romanian Transfer Price Documentation (PwC, 2015. International Transfer Pricing 2015/2016).

while in Italy by the tax return filing deadline. Unlike in Italy, penalties and fines exist in Romania for not complying with documentation requirements, and are calculated as a percentage of the adjustment to taxable income.

Before analysing the method chosen by Marchesi, some specifications about the two entities (Fonderia Marchesi Srl and Marchesi Eastern Europe Srl) and their commercial relationship must be made, in order to fully understand the dynamics around them. Both companies are manufacturer and not only Italy sells to Romania, but also vice versa. In particular, raw materials are sold exclusively by Italy to Romania because of the convenience in purchase prices, while mutual and reciprocal exchange exist as regard finished goods, work-in-progress (WIP) goods and also services (for example the rental or the exchange of machineries between the two entities, due to disuse or need). Regarding the situation in terms of authority instead, the two companies place themselves on two different levels. Fonderia Marchesi Srl has a quasi-totalitarian control over the Romanian subsidiary, which is not a cost, profit or investment centre, but a "controllata a maggioranza" as it is defined in the article nr. 2359 of the Italian Civil Code. It is managed by three directors, two of them Romanian and one Italian with power of veto. They have their delegations and autonomy for what concerns routine management and day-to-day business, while only a limited power is given them for extraordinary administration (they have for example expenditure limits for what concerns investments, whose intentions must be communicated to and approved by the Italian group). There are not problems of control of the subsidiary for Fonderia Marchesi, as the relationship and the transactions between them are characterized by transparency and clarity, they trust each other and there is confidence. Nevertheless, the parent company wants to be present and part of the decision-making (for instance, the sale prices are set by both the firms together) and decided to externalise the accounting system by commissioning an accountant who ensures that everything proceed in the correct manner. In this way, the central management have complete access to the subsidiary's financial statement and knows exactly how and where its directors decide to invest money. The parent company receives by the accountant, with whom has a direct relationship, detailed information through a monthly report containing useful data necessary for having everything under control and in line with regulations. This kind of internal audit structure is very pervasive and allows the group to work with crystal clear data and to avoid possible unpleasant surprises, as everything is known and directly traceable. The measurement of the performance of the Romanian company is carried out through a verification of its profitability (so the calculation of its profit margin), above all for a reason of possible improvements and developments.

Regarding the theme of innovation, Marchesi Eastern Europe Srl is exclusively a production plant, so its managers are not evaluated for their innovative idea, as they are asked to carry on just the manufacturing activity. Innovation is fully concentrated in the Italian parent company, which eventually "exports" ideas about possible new products, upgraded working cycles or also updated financial procedures.

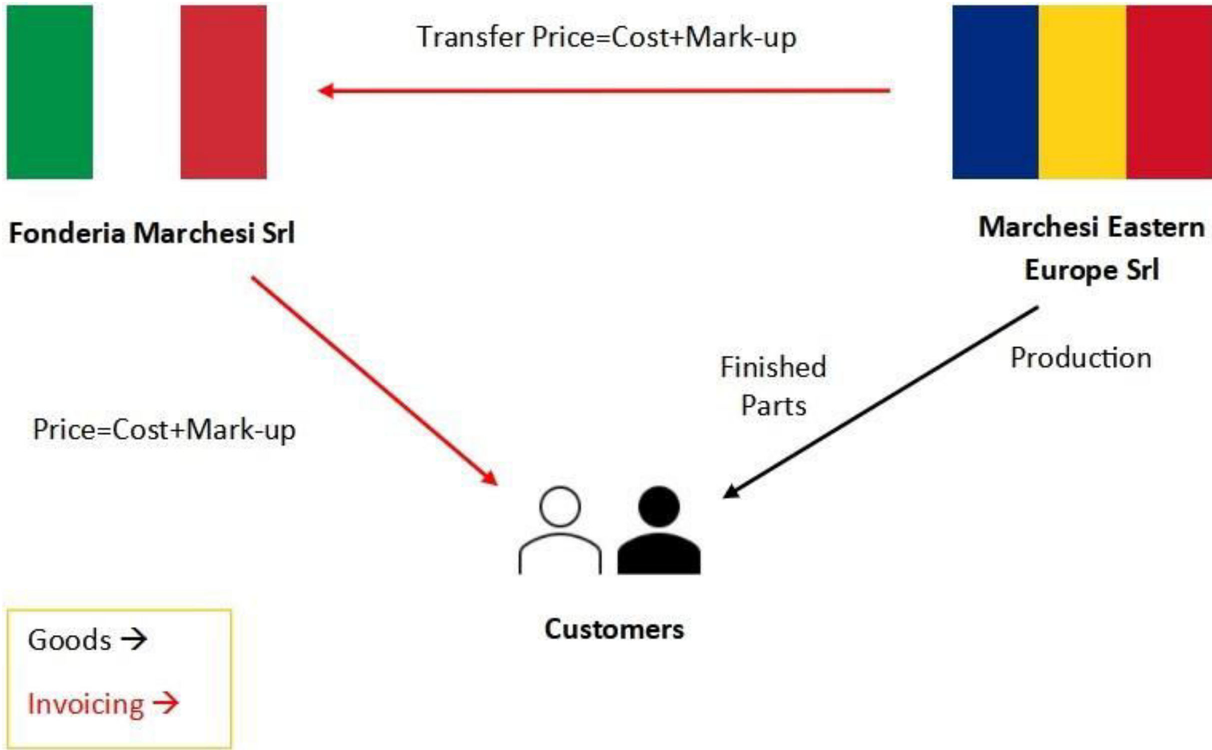
An important brick in this study is the concept of compensations. Although the group operates with goal congruence and without information asymmetry, Eleonora confirmed that "a new approach will be adopted in the near future, which is the Management By Objectives (MBO)". This strategic management model has the purpose of improving the performance of the organization by clearly defining objectives (in this case for the Romanian plant) that are agreed together by both companies' management. This has not yet been implemented because in order to do it the group must possess an adequate economic base to be able to sustain it, and in the industry in which it operates the period of time to break even and to start earning is of about 5 years. Figure 17 illustrates the typical process of an MBO process, starting from the definition of organization goals to finish with performance evaluation.

Figure 17: Management By Objectives (MBO) process (Corporate Finance Institute, https://corporatefinanceinstitute.com/resources/knowledge/strategy/management-by-objectives-mbo/)

Coping with the method adopted, Marchesi chose a combination of the Cost-plus Method (CP), one of the three Traditional Transaction Methods (with the CUP and the RP methods), and of the Profit Split Method (PS), a Transactional Profit Method. Beside that, the Transactional Net Margin Method (TNMM) is implemented to test the other two and to find comparables using the Bureau van Dijk (BvD) database, assuming Romania's company as the tested party because of its less complex role of contract manufacturer and comparing its net plus cost margin with the one of the selected comparables. The price of the products using the CP method is made up of cost of production plus a mark-up consisting of a percentage of the cost calculated basing on a risk and functional assessment.

The transactions can be divided based on what is being sold or purchased:

1. Sales of finished goods and products: this kind of transaction occurs both from Fonderia Marchesi Srl to Marchesi Eastern Europe Srl and vice versa. The following schemes illustrate the situation.

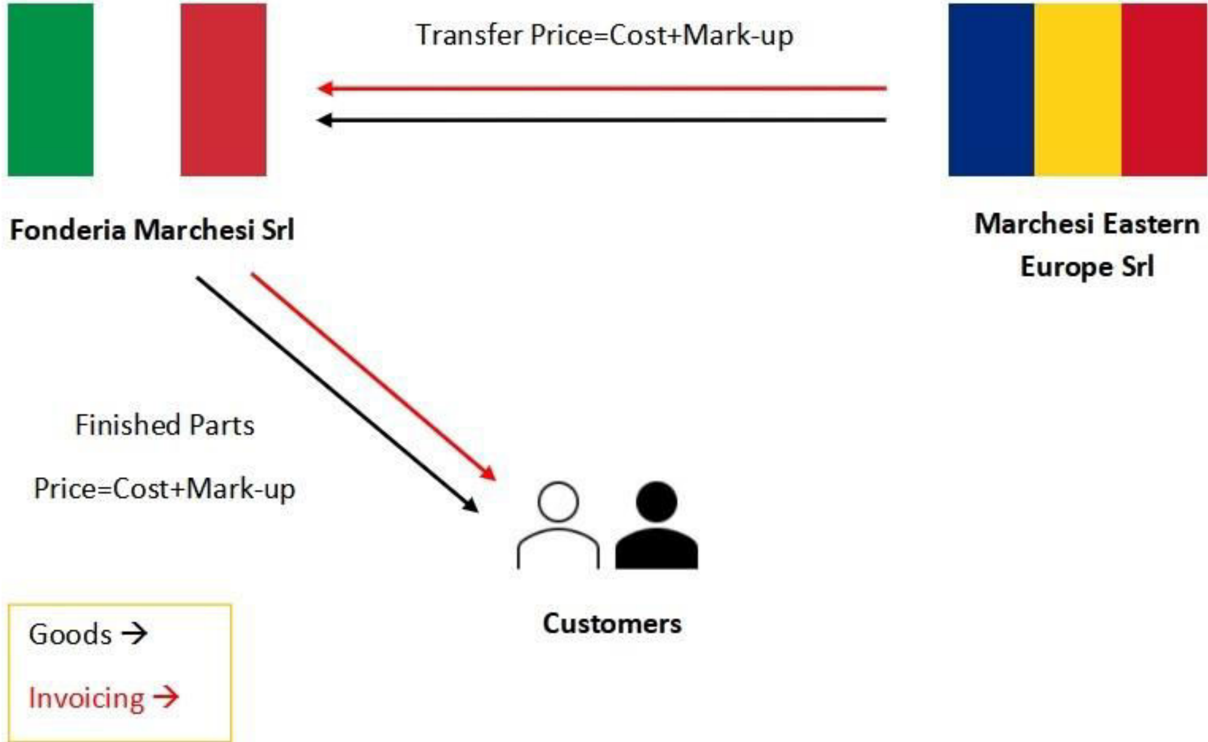


Scheme 1: Purchases of finished products – shipped directly from Romania to customers (Marchesi, Ricozzi, 2020).

The first one (Scheme 1) describes the purchase of finished products, shipped directly from Romania to customers. Romanian company manufactures the goods, which are then sold directly to customers. In this case the invoices are made by the Italian company due to a long-

lasting relationship of trust built among the years between customers and Fonderia Marchesi Srl.

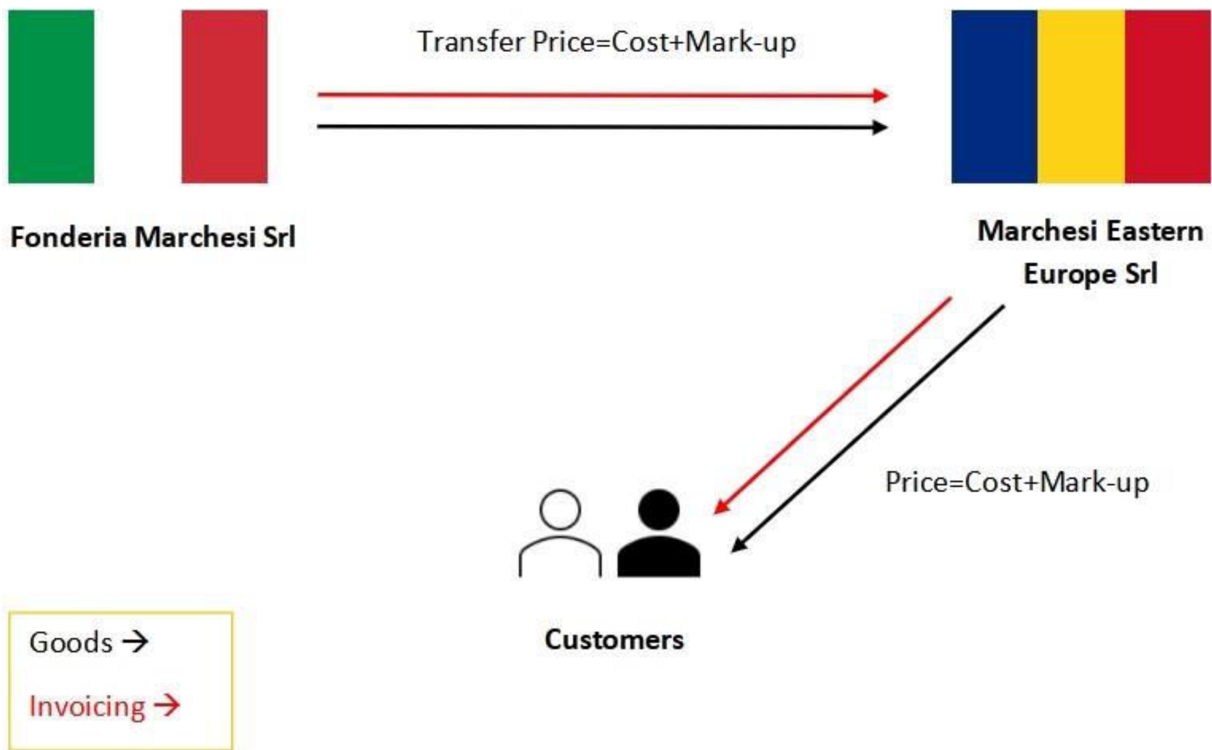
The second situation (Scheme 2), always about finished goods, involves the shipping of the products from Italy to customers through a consignment stock agreement. This means that, after the Romanian production and the transfer of the goods to Italy, the products are sold to customers at the price equal to the cost plus a percentage mark-up.



Scheme 2: Purchases of finished products – shipped from Italy to customers through a consignment stock agreement (Marchesi, Ricozzi, 2020).

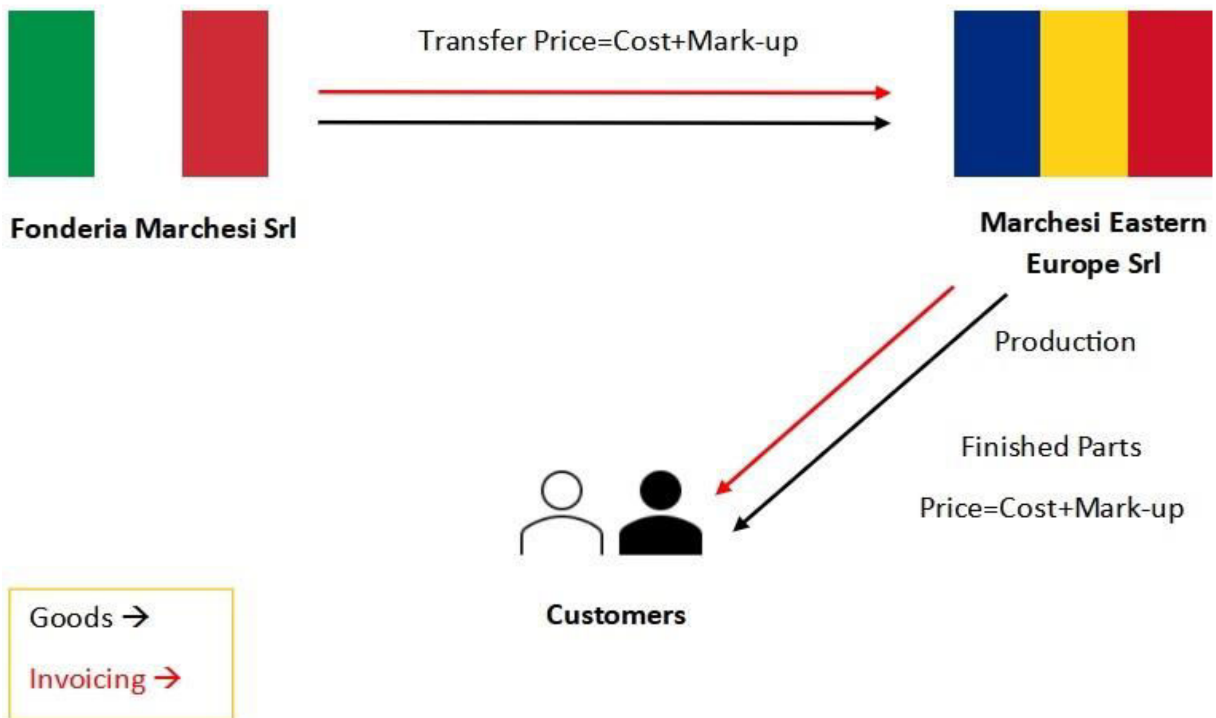
The third situation (Scheme 3) illustrates the sales of finished goods by the Italian company to the Romanian one, which then sells the goods to customers, being responsible also for the invoicing.

2. Sales of production components (or WIP goods): also this type of transaction occurs both from Fonderia Marchesi Srl to Marchesi Eastern Europe Srl and vice versa. The following scheme (Scheme 4) illustrates the situation.



Scheme 3: Sales of finished parts (Marchesi, Ricozzi, 2020).

In this case the WIP goods are sold to Marchesi Eastern Europe, always following the CP method. Once it receives the goods, the production is completed and finished parts are sold to

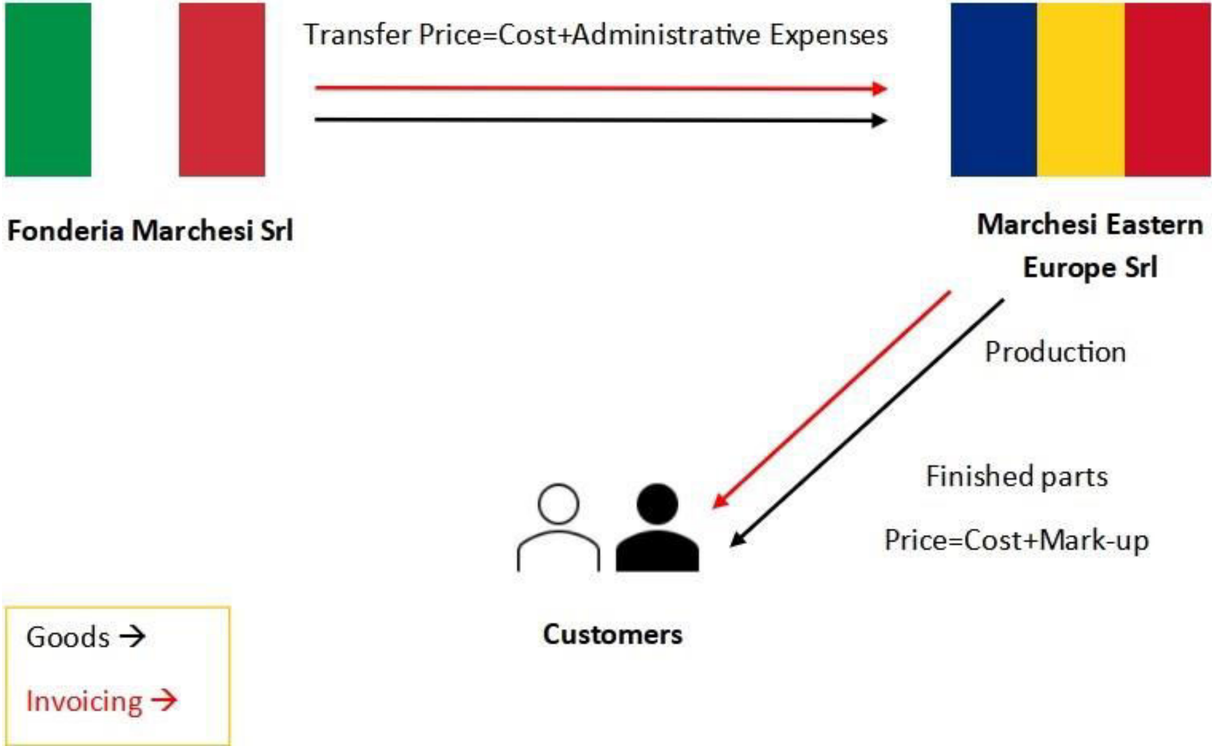


Scheme 4: Sales of production components (Marchesi, E., Ricozzi, M., 2020. Transfer Pricing Presentation).

customers. Romanian company is responsible for both the sale and the invoicing. The same happens on the contrary, when Fonderia Marchesi produce the finished goods using production components received from Romania. The Italian company is responsible for both the sale and the invoicing.

3. Sales of raw materials: as we have seen before, a characteristic of this transaction is that it occurs exclusively from Italy to Romania, owing to the convenience in purchasing prices.

Marchesi Eastern Europe Srl, after having received the raw materials from Italy, use them for the production of finished goods which then are sold directly to customers, and being responsible also for the invoicing. The amount of the transfer price corresponds to the cost plus a percentage of administrative expenses incurred during the purchase.



Scheme 5: Sales of raw materials (Marchesi, Ricozzi, 2020).

The process that led to the choice of the right transfer price happened una-tantum. As can be imagined, this one time was time-consuming and complex: the responsible for this decision was the same Eleonora Marchesi together with a consultant both in Italy and Romania. This procedure lasted more or less one month, time in which different methods and all the risks were mapped. Clearly, every year an assessment lasting a month and a half is carried out, but not to

re-establish the method. The purpose is to make the dossiers on an annual basis, which consists of tracing the transactions, defining the components of the income (accruals and deferrals), making sure the two account systems reconciliate, redefining product cost sheets for the products involved in new transactions, in order to have a system that makes sense. Every transaction must be traced, together with all the purchase invoices of all the suppliers, to prove the method is being used. After that, a benchmark analysis is conducted using online databases with all the necessary information and data to make a comparison with other MNEs or companies of the same industry.

The reasons behind the choice of these methods are linked to the business and industry in which Marchesi Group operates, characterized by commodities that usually don't have any or many comparables. It's about unique products that are designed, projected and even patented directly by the clients, who turn to the company with a clear-cut and definite idea of what they need. The CUP method was discarded because of its suitability most of all for products with a comparable market price, which is not the case of Marchesi commodities products. In the RP method, usually one of the two entities involved in the transaction has to be a distributor, while in our case both Fonderia Marchesi Srl and Marchesi Eastern Europe Srl are manufacturing centres. The TNMM is implemented because of its usefulness in testing, assessing and comparing the other methods used, to check if they are and continue to be adapt for the type of transactions in place. The CP and the PS, respectively operating at the single product and at the unit level, are the most appropriate methods for the business characterizing the group and both finished goods and WIP goods.

There are some aspects to take into account when establishing a transfer price. One of the most important is the definition of functions and risks for both the entities engaged in the transaction. These are connected with productive aspects and logistics: for example, if the Romanian company sells a finished good instead of the Italian one, for sure it will bear more risks in doing so. Another point is the partition of the margin: market and client risks must be considered, as who bears more risks will gain consequently a higher margin. Regarding WIP goods, the margin is split depending on the product cycle, with percentages directly attributable the responsible centres. Fundamental at this point is the cost accounting system, that has to be detailed, precise, well-made and accurate. To do so, the product cost sheet is an essential feature: it is a useful tool that allows the calculation of the cost of products through an automatic valorisation of the materials of the Bill of Materials (BOM) and of phases making up the working cycles (the cost per hour must be as correct and precise as possible). What is crucial is that there is a

reconciliation between the two accounting system, the cost accounting and the financial accounting.

Maybe the most important part of the study about Marchesi Group transfer pricing system is the one concerning the two main components of transfer pricing, namely the one related to the internal decision-making, so involving cost and management accounting, and the one related to its external use, so for the report to tax authorities. Eleonora stated that "starting to deal with transfer pricing represented an occasion for Marchesi Group, since the attention we have to pay switched from the tax context of the first years in which we approached the matter, to the internal structure of accounting". If earlier the company was obliged to comply with transfer pricing rules and procedures and what it did was just that, recently the tendency has moved towards another great opportunity. This occasion is reflected in the building of the company's cost management accounting, which over the years has become more well-structured, strengthened and consolidated. In reality, this was not just an occasion, but the company was in some way forced to deal with it, since it represents a basic and an essential tool to manage transfer pricing. So initially, the commitment to obtain or extract data and information for the management of the cost accounting system was great, as the first building phase of this internal structure required great efforts in terms of time, amount of work and data management. Just to make an example, the management of costs related to energy, in particular electricity and gas, is hugely affecting the group that has to cope with an excessive consumption, since it belongs to a capital-intensive industry. As usually happens, great efforts lead to results and conclusions that nowadays are essential for the improvement of a company. This internal cost accounting system, if well-kept and meticulously made, proves to be pivotal for the group, as it is a useful framework to control costs, estimate the ones of the products and evaluate inventory. This can lead to a potential increase in efficiency, a reduction in costs through improvements in Times and Methods sector, and the possibility to trace responsibilities to specific departments, thanks to monthly prepared reports which identify where the money is spent, how much the group is earning and above all where money us being lost. In a few words, a cost accounting system allows to prepare useful information about costs which, once analysed, can lead to the improvement of internal cost control and efficiency. It helps the group in understanding how to use better its resources by tracking and measuring them and most important is beneficial for dealing with internal costs like transfer prices. Moreover, cost accounting can inform better decision making, by assessing all the possible strategies within the business, such as cost-volume-profit analysis (CVP), level of production or investment appraisals; for sure, it guides

the pricing process, as implementing standard costing is equivalent to work with real figures and not estimates. And at last, it helps the management to decide when to outsource the production or not, based on if the internal production is profitable or if it is cheaper to move the manufacturing cycle elsewhere. But the soul of cost accounting resides in the concept of budgeting: estimating revenues and expenses over a future period is essential to operate and perform at the maximum of the efficiency.

To summarize the last idea, the first time Marchesi group faced the issue of transfer pricing, it started by treating it just for tax and penalty compliance. Among the years, with the establishment and the enhancement of the cost accounting system, which was born for the management of transfer pricing, the focus changed and the system became in all respects a strategic tool.

To conclude this chapter, Marchesi Group has never had disputes or troubles with OECD or other institutions or tax authorities, as it works with transparency and clarity without making infringements or violations of the law, for example without decoupling its internal transfer pricing from the external one used for tax purposes (if the Italian Tax Authority, the "Agenzia delle Entrate" requires every kind of data, the group can supply all the materials or documents needed).

Chapter 5

Eclisse Srl

Figure 18: The logo of Eclisse Srl (Eclisse website, https://www.eclisseworld.com/).

As we did for Marchesi in the previous chapter, the second case study concerning Eclisse Srl starts with a presentation of the company, the sectors in which operates, the products manufactures and the services offered, and then goes into a detailed description of its transfer pricing system. The presentation follows in broad terms the one of Marchesi Group.

5.1 History of the company

The foundation of the company dates back to the January of 1989 thanks to Luigi De Faveri, who established Eclisse Srl in Falzè di Piave, a small village in the province of Treviso. He had an idea, a concept and a mission to change the sector of sliding doors, that back then had a very bad reputation based on old fashioned systems of tracks hand-built into walls. They were often noisy, unstable and unbalanced, they jumped off the tracks and had sticky sliding actions; in a few words, sliding doors were really only used when there was no alternative, they were never considered to be a positive design feature. This entrepreneurial project actually started in the 1960s in a metal carpentry workshop, developing over the years thanks to continuous research of advanced industrial systems, allowing the company to compete in the current highly selective market. The year of the creation coincides with the beginning of the production of what are considered the historic products, Eclisse Single, Double, Novanta, Telescopic and Unilateral. In the two-year period between 1991 and 1992, the company obtained its first two patents: the first is the coupling system without welding of the mesh to the counterframe (for the plaster version) (Figure 19). The absence of welds avoids the rust and possible mesh detachments. The second patent relates to the extractable track. 1996 was a great year for Eclisse Srl: it moved from

Figure 19: The coupling system without welding of the mesh to the counterframe (plaster version). (Eclisse website, https://www.eclisseworld.com/).

Falzè di Piave to the near Pieve di Soligo, within a dedicated structure, and it inaugurates the first subsidiary in France, exactly in Quimper, under the name of Eclisse France. Following that, the expansion and consolidation in international markets leads Eclisse to Poland, with the opening of Eclisse Polska in Tczew. With the new millennium the company obtained the third patent for the under-frame tear-off profile and launched the first website. In 2001 the distribution network expanded to the Austrian territory, with the opening of Eclisse Wien, and the Czech Republic, with Eclisse CR in Prague. In the following years, in terms of production, Eclisse revolutionized the concept of the counterframe and produced Eclisse Luce, the system prepared for the insertion of electrical wiring, and Eclisse Circular, the first counterframe for curved pocket doors in the market. Other two patents are added to the list: the self-centring lock system, which allows to reduce the installation time while guaranteeing an optimal centring and closing functionality, and the alignment bar, which keeps the counterframe perfectly aligned during installation, avoiding structural twists. Another great year was 2006: it consolidated its presence in Spain by the establishment of Eclisse Iberia; it opened Eclisse Slovakia in Banskà Bystrica; and it marketed the first version of pocket door without jambs and architraves, called Eclisse Syntesis Line. The year after marked an important step for Eclisse: the first overseas subsidiary, Eclisse Brasil, was created in the city of Vila Velia, expanding the company presence to Latin America. The spread continued with Eclisse Deutschland in Germany in 2008 and with Eclisse Est in Bucharest, the subsidiary in Romania. From 2010 onwards, the company witnessed the receiving of other patents (Eclisse Ewoluto Single and Double), the opening of several showrooms in Milan, Prague, Perugia, Pescara, Munich and London, and the presentation of other products, such as the Eclisse Syntesis Luce, the Eclisse Syntesis Flush Collection and Shodo Collection, Eclisse Syntesis Tech, the Eclisse BiasDS, Eclisse Syntesis Battente Glass and Eclisse Acoustic.

Figure 20: The alignment bar (Eclisse website, https://www.eclisseworld.com/).

5.2 Mission, innovation and certifications

The motto of Eclisse "Looking Further" is the reflection of its philosophy: a promise the company repeats every day, a commitment to see what others do not see, the meticulous attention to detail, a willingness to take nothing for granted. In a few words, the synthesis of its work, what makes it different. Eclisse is always trying to move towards perfection. The group strongly believes in the superior quality of its products and its purpose is to develop and manufacture counterframes that are innovative, robust, easy to install and easy to inspect, at any time. The collective ambition is to revolutionize the concept of counterframe for sliding pocket door systems and frames for hinged doors, and to be the answer to every functional and space needs, constantly innovating systems through practical and design solutions. Counterframes for sliding pocket door systems and frames for flush and splayed hinged doors are made to be installed inside the wall and allow the door to slide or to guarantee its perfect flushness to the wall. A counterframe, once installed, becomes part of the wall, but at the same time it must allow for a door to slide properly inside. A frame for flush or splayed door must be resistant, and perfect, so that the hinged door can be closed in line with the wall. The company started by listening to users and installers, with the aim of developing new ideas and excellent solutions, despite having more than 30 years of experience and having obtained more than 40 patents, always improving itself day after day. The goal is to ensure a reliable, robust and cutting-edge product that can perform perfectly. Eclisse reinvented the counterframes and frames in quality efficiency and aesthetics, thanks to technologies and components which allow to obtain the most advanced sliding pocket door systems and hinged door frames. The quality of the products is experienced both during installation and in everyday use, through various state-of-the-art technical details that make the difference, such as the design ensuring an easy installation, the perfection of the mechanisms and the excellent aesthetic, guaranteeing the uniqueness of the models. One of the essential concepts of the company is to pursue the satisfaction of its customers, employees and all the stakeholders who come into contact with the group through continuous improvement of business processes, of the health and safety of its workforce and collaborators and through acting responsibly for the environment. In fact, through the years, it kept pursuing its commitment through the achievement of internationally

Figure 21: The fully extractable track (Eclisse website, https://www.eclisseworld.com/).

Figure 22: The certified runners (Eclisse website, https://www.eclisseworld.com/).

recognised awards and certifications in the areas of quality, safety and environmental responsibility. Some of the components that received a patent or have been certified are the fully extractable track, the runners, the alignment bar, and the under-frame tear-off profile. The patented fully extractable track (Figure 20) allows the user to easily extract the rail where the door slides, to clean it, replace it or to install accessories at a later date. Also, the door stopper can be moved into the desired position, and it can be decided at any time how much of the open door will remain protruding from the jambs. This is innovative because the sliding of the door is not compromised over time and the wall doesn't have to be pulled down in order to remove or substitute the track. The runners (Figure 21) with ball bearings provide smoothness and fluidity to the system. They are tested and certified to guarantee durability, smooth movements and a silent sliding. The patented alignment bar simplifies the installation, since it is a special galvanised metal sheet profile that provides a rigid union and the perfect alignment between the pocket and the metal door post, ensuring the squareness of the counterframe and that the door slides and closes properly. The under-frame tear-off profile avoids the unpleasant slit at the bottom of the frame once the floor is finished and the door is installed in the pocket system. The base of the pocket, already installed, can be easily removed as the ring-pull of a can to lower the brick base beneath it and achieve the correct height, levelled to the finished floor.

Figure 23: Under frame tear-off profile (Eclisse website, https://www.eclisseworld.com/).

5.3 Products

Eclisse can offer a wide range of products, despite the sector to which belongs seems to be poor in what it can offer and also in competition. The oldest one in terms of years of life, as the name can suggest, is the Classic Collection, which includes systems that shaped the history of sliding pocket doors, and in general sliding pocket door systems with jambs. It offers solutions to eclipse a single door or two mirrored sliding doors, to open wide passages (Telescopic) even in curved walls (Circular) or to enter two separate rooms with the footprint of a single system (Unilateral). Another collection who had a great success is the Syntesis one, including sliding pocket door systems without jambs and architraves, hinged doors and baseboards flush with the

wall, and trap doors for technical hatches that disappear into the wall. The main characteristic of this collection is the complete design vision sum of different high technologies, perfectly integrated into the wall. A newly introduced is the Eclisse 40 Collection (Figure 24), considered the next step in the innovation of flush doors. Inclined at an angle of 40 degrees, the door frame is no longer just a technical and functional element, but it becomes also a decorative element itself. Other two collections are the Luce and the Care one. The former refers to wiring-ready sliding pocket door systems, designed to allow the insertion of wires and the installation of light fittings, switches, thermostats, and telephone wiring in the same wall section where it is hosted. The latter represents a special solution for the mobility of elderly and people with disabilities, offering a functional, barrier-free living space because it takes into account the accessibility requirements of buildings. Beside these collections, the company offers also exposed sliding doors which slide along the wall, a great variety of accessories to customise or enhance the sliding pocket door systems and hinged doors, and a range of baseboards.

Figure 24: Splayed side vs Flush side of Eclisse 40 (Eclisse website, https://www.eclisseworld.com/).

5.4 Global presence

As it was introduced earlier, Eclisse Srl has expanded its presence all over the world during the years. At the moment the group possesses a sales network made up of subsidiaries, agents and organized distributors, depending on the origin of the demand. To date, the group controls 10 subsidiaries, 9 of which are located in Europe and one overseas in Brazil. The European ones are situated in France, Spain, Austria, Germany, Poland, UK, Slovak Republic, Czech Republic and Romania. The activities performed by all of them are commercial activities with the assembly of some details: the companies buy the products from the parent company in Italy and under the protection of a sales contract with exclusive[7], through their sales networks, sell the products throughout the territory. Eclisse France also covers the Belgian territory and Luxembourg. Improvements in commercial relationships with the USA will lead to the

[7] It means that in the contract an exclusivity clause has been included, according to which the supplier is obliged to sell the products exclusively to one distributor (the subsidiary) in the chosen territory. In this way, the supplier cannot commission other distributors, agents or intermediaries for the distribution and cannot sell directly to its customers. (www.confindustria.it)

establishment of a new subsidiary in the American country planned for the year 2022, with a significant consolidation of its position in such a remarkable market. Besides the subsidiaries, Eclisse covers numerous other territories, as the geographic markets are located in all the continents with prevalence of Europe, Russia and USA. In Europe the sale happens mainly through subsidiaries, but when they are not present, as in Russia, Eclisse avails itself of independent importers, who are responsible for the distribution of the products throughout the country. The commercialization is mainly aimed at large-scale retail trade, doors manufacturers, hardware shops and dealers of building materials. The parent company in Italy makes use of a network of agents that covers the entire national territory as well as all the subsidiaries in their respective territories; moreover, in England sales are also made directly to the final consumer via website (the so-called e-commerce).

Dealing with the relationship between the parent company and its subsidiaries, the provision of intra-group services refers to the free use of the "Eclisse" brand, the layout of the standardized website, as well as employee training courses, participation in trade fair events, transport costs and advertising. All these services are free of charge because all the relationships between the parent company and the various subsidiaries are governed by exclusive sales contract for the assigned territories. Eclisse decided to act in this way because this mode of provision of services was considered of interest for both the group and Eclisse Srl. The parent company is the company of the group that owns the intangible assets providing at its headquarters the design and registration of trademarks and the layout of the website, of patents, utility models and designs (such as ornamental models) both in Italy and in Europe, the research and development, the realization of prototypes and samples, the technical, safety and production tests, the organization of work (methods and techniques of production and construction of products), technical and commercial training, both of its technical and commercial staff and, for the latter, also in favour of the associated companies. The subsidiaries use all the potential offered by the parent company free of charge. With reference to the brand and the website, the only commitment of the subsidiaries is to protect and assist the parent company in the protection of the brand and in the exclusive use of the website in the countries of competence, which has the same layout in every one of them. In addition, the subsidiaries through the exclusive sales concession contract undertake to use the brand on all products sold. With regard to other intangible assets (patents, models, designs and know-how), the parent company exclusively uses them in a confidential form for the purpose of producing its products. As the parent

company is the sole producer, all intangible assets are automatically part of the product evolution, and the related cost is implicit in the selling price to the subsidiaries.

5.5 Transfer Pricing

As we did in the previous chapter, before analysing Eclisse's transfer pricing system, we present its organizational structure and accounting system, to get into the argument in which costs represent the key element.

All the useful and interesting information we are about to present is coming from Stefano Spinetta, controller of the company since 2015. He works in the headquarters of the group in Pieve di Soligo and he is the sole responsible for the cost accounting management in the company. Recently his office has joined the administrative one in terms of hierarchy, becoming part of the senior management, due to the strong relationship and the continuous interchange of information between them. Nevertheless, he maintains his autonomy as its job differs from the ordinary one of the administrative office, in which invoicing and payments are managed. In this department six people are employed, all of them high school graduated in accountancy. Stefano, on the other hand, graduated in the Master's degree programme in Business Management and Marketing at the Ca' Foscari University of Venice.

As presented before, the founder of the group in 1989 is Luigi De Faveri, who today, together with his wife Gabriella, are the CEOs, making it a family-run company since the beginning. The only exception is represented by the subsidiary in UK, which is governed by a pool of employees for a total of 66,6% of the shares, while the remainder by the parent company. The Italian headquarters are located in Pieve di Soligo and provide employment for almost 200 persons for the manufacturing and more or less 70 persons in the offices. Its last turnover is calculated at about more than 50 million euros, with a high and constant growth over the last years of about 10% to 12% per year. Eclisse's business is characterized by B2B transactions, meaning that it sells its products to resellers and retailers specialized in the sale of products related to this industry (an example is Home Depot, the largest home improvement retailer in the United States), while private clients can turn to the subsidiaries or agents (in countries without subsidiaries). As the company manufactures products which need to be complemented by other components as doors or knobs, usually the sale is made as a bundle including all the parts and elements (for example door panels and their relative accessories) to have a completed result once all of them have been installed. The establishment plan of the company is organized per functions, as Eclisse adopted and works with a functional organizational structure. There

are various interconnected departments working together for the achievement of the overall results. These are the purchasing department, the marketing, the foreign and Italian sales offices with their respective back office to support the sales, the administrative office, the technical one, the quality area, the logistics, the manufacturing, the design office and the data centre (CED Service in Italian).

Entering the world of costs, and in particular the cost accounting system, Eclisse couldn't do anything but implement both the process costing and the job order costing. The reason is simple and is about measures: while the former is normally used for products considered as standard in terms of measures, the latter is employed in those cases the products' measures, as the height, width or thickness, differ from the standard ones, and particular machining or workmanship have to be applied to manufacture them. These products are called "fuori misura" (special measures) in Eclisse and, although frequently requested, they represent only a small fraction, ranging from 5% to 10% of all the manufactured products. The allocation of costs to products is carried out through variable costing, even if Stefano prefers to define it as "direct costing based on the standard working hours". This special form of cost analysis only makes use of variable costs in taking decisions, without considering the fixed ones. These last are associated with the period in which they incurred, as suggested by their name "period costs". The advantages of this method are multiple, above all for short term decisions, although overhead costs are not allocated to direct costs. Maybe the most helpful is about cost reporting: in fact, direct costing allows the application of variance analysis reports, in which actual variable costs are compared with what the variable costs per unit should have been. Other positive aspects relate to the possibility of automation investments, specifically for the purchase of production equipment to reduce the costs traceable to direct labour of the staff; the evaluation of customer profitability, to understand how much money the group is earning from every single client and consequently deciding to continue or eliminate this relationship; the capability of conducting profit-volume analysis, in order to estimate how much profit the company gets at different levels of activity; the theme of outsourcing, as direct costing helps in deciding whether to produce and manufacture inside the company or to outsource it. A particular practice is carried out for the establishment of products' costs at the end of the year: while during the year standard costs are continuously updated and communicated to salesmen in what can be defined as rolling budgets, the cost needed at the end of year is represented by an average cost calculated taking into consideration all the previous costs incurred throughout the year. This is the one used to update the price lists for the different countries and subsidiaries. The concerned cost is

determined by a statistics tool part of the management software of the company. This Business Intelligence platform is exploited by all the functional departments of the firm, and it helps in improving the overall performance because it provides a real-time dynamic analysis offering a quick view of the trend and progress of the group; it transforms the data present in the system into useful indicators for a proper interpretation of the monitored phenomena; because it employs a simple and interactive user-interface which offers the possibility of exploring, filtering and carrying out research in a quick and accurate way.

In pricing its products, Eclisse adopted the cost-plus method: once the amount of costs sustained for manufacturing a product (so when a product is valorised) is communicated to salesmen, these latter have everything in their hands to apply a mark-up percentage on that cost for which they can make a margin and earn a profit. This process involves the analysis of several features fundamental for the establishment of a fair and correct price. The two most important factors are the target profit, i.e. following the corporate objectives in terms of margin and revenue targets, and as mentioned before, all the costs and expenses incurred to manufacture the product and to make it ready for the sale. Besides, the characteristics of the market in which we are moving, for instance local markets if we talk about the sale to subsidiaries, must be taken into account: these includes the purchasing power of the citizens of a specific market, which relates to the trend of the foreign currency that must be always kept under control, the presence and number of competitors, and of course the types of products present in the market. All these elements together, if well-balanced and thoughtful, lead to an adequate product pricing that can bring excellent results in terms of profits and position in the market.

After this inception to the paragraph, the system of transfer pricing can be examined in detail. Regarding Italian and Romanian laws and regulations governing transfer pricing, a reference can be made to the previous chapter, as they are the same since both case studies concern an Italian parent company and a Romanian subsidiary.

Eclisse Est, the Romanian subsidiary of Eclisse Srl responsible for more or less 1% of the turnover of the group, operates in a rented building and is equipped with IT equipment for administrative and commercial management as well as some small equipment for the adaptation and installation of counterframes in case of special measures. This furniture also includes a fleet of vehicles used for transport and representation. However, it is just considered as a distribution centre since it purchases finished products from the parent company in Italy and nothing else. There is no exchange of raw materials or WIP goods between them, except for some rare cases

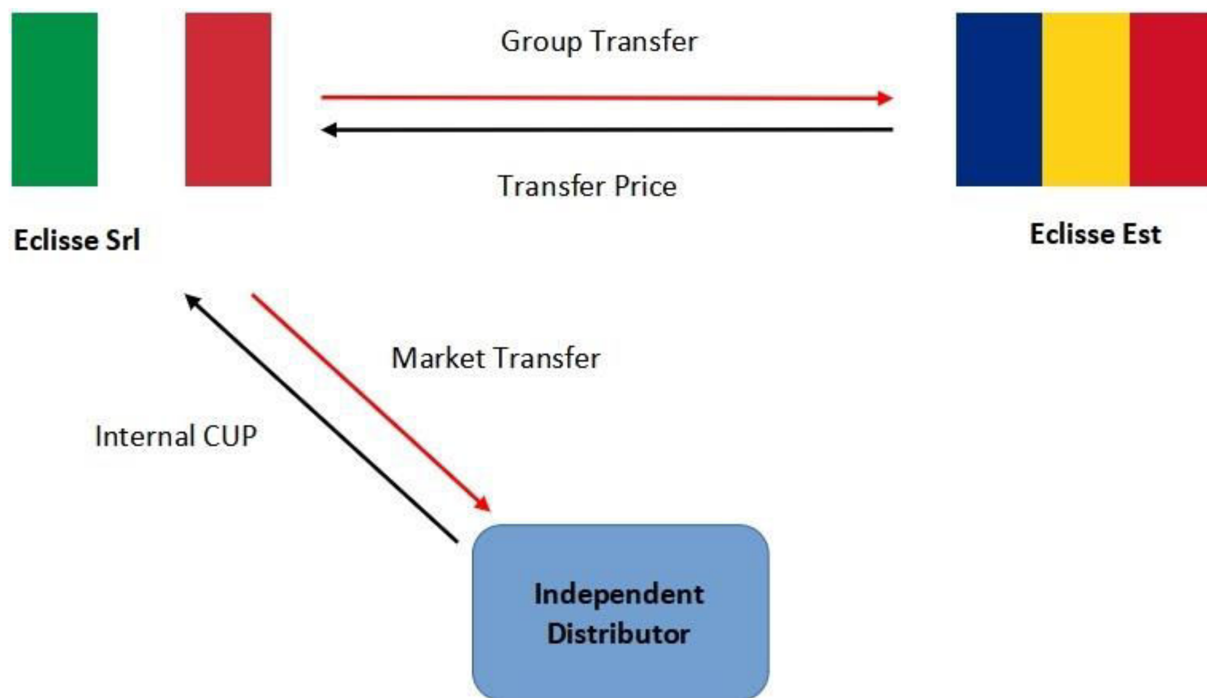
in which parts are assembled on site. So, if we have to do a comparison with Marchesi Group, the situation appears to be simpler and less complicated, because commercial transactions happen only from Italy towards Romania and just for finished products. Dealing with subsidiary managers (the partners), the level of autonomy in decision-making is very high, as they are responsible in all respects for the management of the local market, but clearly abiding by the guideline issued by the parent company. In this respect, Stefano states that "the subsidiary is considered a profit centre, since having and owning a local unit allows to have more control of the evolution of the local market, giving us the opportunity and also the capability to meet customers' needs in an effective and efficient way". As a profit centre, Eclisse Est management can't control investments, but is responsible only for the profits obtained from operating the assets assigned to them by the headquarters in Italy. The firm's central management has complete access to divisional financial statements of the subsidiary, in particular twice a year on the 30th of June and on the 31st of December, and is responsible for the preparation and the filing of the consolidated financial statements. These two periodic trial balances are essential for the evaluation of the division's performance and for monitoring its trend. In addition, reports relative to ordered and turnover are sent periodically to the parent company in order to check the status. These useful elements together help in putting on track corrective actions when needed. The control system of the income statement provides basic and key information necessary to know where to intervene. The capability of the local manager is measured through the budget which is jointly developed for every country in which a subsidiary is present. Moreover, a great help and step forward in the relationship between them is represented by the company IT evolution, which made and make it possible to recover the required data from the subsidiary in a faster and more practical way.

As regards group's values, they are transmitted to the various subsidiaries' managers who are responsible for their replication in the distinct local markets in which they act, but adopting multiple communication strategies according to the countries' development. For each subsidiary, the budgeted income statement is annually drafted and then controlled, supervised and adjusted every six months, or even every three months in the case a more precise and intense control is needed. A basilar cornerstone of the group is goal congruence: every manager of every subsidiary accepts and adheres to the rules and principles of the parent company, operating with the agreed autonomy towards the same objectives. What the parent company wants its employees to know and have clear in mind is that working for Eclisse means being part of a group and as a consequence committing to improve the overall well-being of the group.

Given the company's constant growth during the years, the transmission of this idea of being part of a family appears to have reached everyone in the corporation, and this is a reason why bonuses, compensations or rewards based on results have never been and are not expected for local managements.

Dealing with the method chosen for managing transfer prices between the Italian parent company and the Romanian subsidiary, Eclisse chose the Comparable Uncontrolled Price (CUP) method prompted by the OECD. This has always been the method implemented by the group since its establishment more than 20 years ago. So Stefano, employed in Eclisse since 2015, tells that "every year transfer pricing documentation is controlled and reviewed, but this is not comparable to the selection process of the most suitable method which took place years ago, and was time-consuming and laborious". This annual check, which involves two days' work, is carried out by four people: the chartered accountant, the head of administration office, the export director and the company's accountant. It includes the recovery of all the necessary data, together with its processing and analysis. Sometimes documentations have to be integrated as per new regulations requiring more information: in this respect, on the 23rd of November 2020, the Italian Tax Authority published new official provisions for the preparation of the documentation on transfer prices in Italy, substituting the ones of 2010. In general terms, the new measures, already applicable from the 2020 tax period, make the Italian documentation of transfer pricing more in line with the latest version of the OECD Transfer Pricing Guidelines in terms of the content of the documentation.

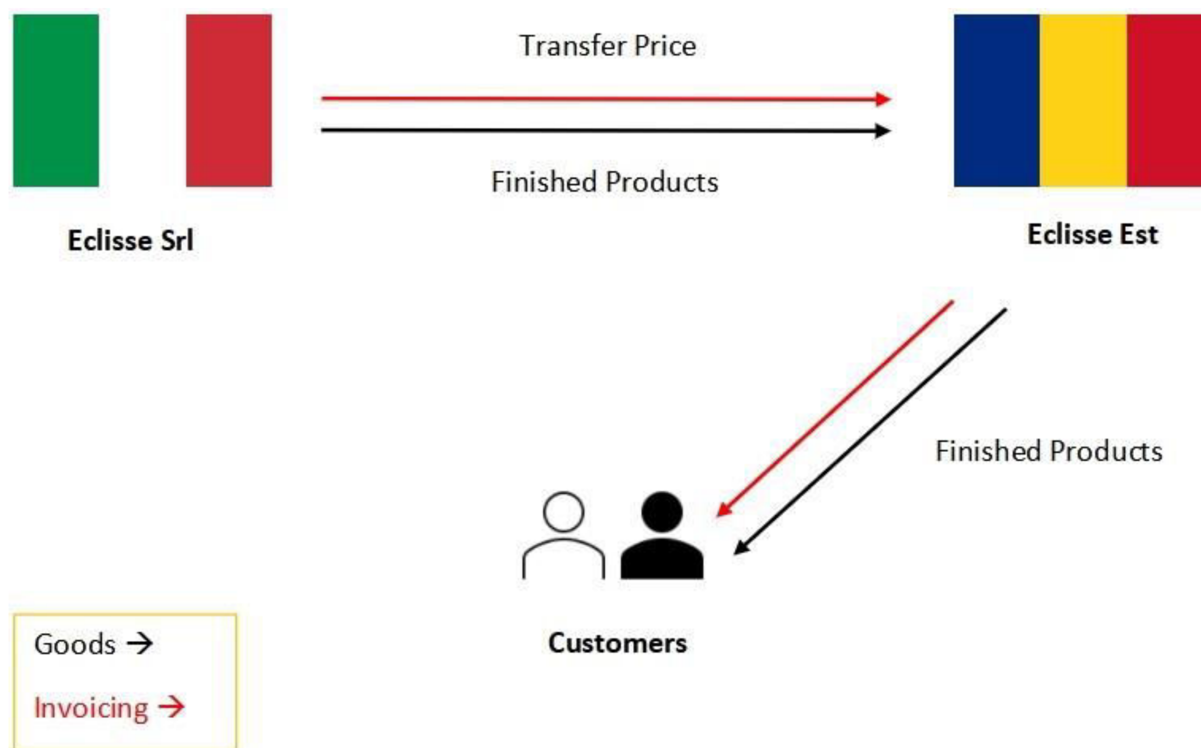
For the purpose of verifying the adequacy of the intra-group price to the arm's length price criterion, Eclisse considered the CUP method the most direct and reliable one among the five suggested by the OECD, as data is easier to recover. Moreover, it was hinted also by the Italian Tax Authority. The company, following these indications, believed to apply the method of the internal comparison, consisting in the comparison between the price applied intercompany and the price applied for the same transaction with an independent third party (Scheme 6). These prices take account of the existing variety of products in measures and thickness according to the country, together with divergent purchasing powers of states and, as a consequence, different costs. For this purpose, Eclisse Est operates in its own country under the protection of a written contract between the parties, of exclusive sales concession that determines its rights and obligations with respect to the parent company. The latter undertakes to protect the subsidiary for the exclusive right of sale in its territory, committing to provide the design and implementation of advertising initiatives that the Romanian unit has to translate and print in the



Scheme 6: The Comparable Uncontrolled Price (CUP) Method for Eclisse Srl (Our own elaboration).

local language. It agrees to sell Eclisse products exclusively taking care that the brand is expressly displayed on every product. In addition, it is free to sell the products by imposing the price it deems most appropriate and in line with local competition.

The transfer prices from the parent company to the subsidiary are established in the exclusive contract under the heading "conditions of sale" that may be subject to change over time (in fact in Scheme 7 there is only the representation of the transaction, without the price). The procedure adopted for the application of the price is carried out by applying the Italian general list price (deducted from the average of the prices applied to the main Italian or foreign customers, not including subsidiaries, for the various models produced) reduced by the costs of transport and brokerage, that are at the expense of the subsidiary; fundamental in determining the price for the Romanian subsidiary are also the country conditions, the purchasing power, the distribution methods and the market absorption capacity. This method of the internal comparison is considered to be in line with the arm's length principle since the price charged by the parent company for the sale of its products both to Italy and to the foreign subsidiary presents a similar margin of contribution. On the other side, prices charged to distributors resident in countries other than those of the subsidiaries take into consideration the different conditions of the local market and the fact that they are not responsible for services like trademark protection, product promotion or support and assistance, which instead subsidiaries are obliged to carry out.



Scheme 7: The sale of finished products from Eclisse Srl to Eclisse Est (Our own elaboration).

A note has to be made about an essential step of the comparability analysis for Eclisse leading to the establishment of the correct method and transfer prices, that is the risks analysis for Eclisse Est. The latter, excluding the product defect risk, has to bear all the risks related to the business, which were classified according to their level and their type with its variables. The draft of the risks highlights which are the ones probably occurring in Romania: examples include a geographical and social risk due to vandalism, revolutions or riots, as it is a socially dangerous area, or due to the market, as Romania represents a market in evolution; a financial risk related to a liquidity risk, since resources are retrieved by the parent company.

On the matter, Eclisse Srl makes use of a sort of questionnaire for the filling of the transfer pricing documentation and group analysis. Information requested includes: the organizational chart, type of infrastructure used, any other purchases in the country besides Eclisse products, the type and geographical extension of the internal market in which the products are sold (competition, innovation level, product placement, types of customer, price strategies, market geography of the subsidiary, sales agents), financial aspects such as the existence of bank loans, commercial strategies, tax regulations of the foreign state, labour regulations and other institutional factors affecting the activity of the subsidiary, type of communication with the parent company, working visits by the parent company staff.

On the last critical point related to the dualism of transfer pricing, Eclisse consistently differs from Marchesi Group. Stefano stated that “transfer pricing does not represent a strategic tool and it is not used internally for decision-making or to improve the cost accounting system of the firm”. So, he manages transfer pricing just because obliged by the law and its regulations. For internal decision-making and management and cost accounting, the company resorts to internal and external reporting, in which all the necessary information, details and data are contained.

Although operating with transparency, fairness and accuracy, for instance without decoupling the internal transfer pricing from the external one, in 2016 Eclisse Srl was subject to an inspection of the Italian Tax Authority, which after a careful analysis, didn’t contest anything related to transfer pricing.

CONCLUSION

As we had the opportunity to notice through the work, there's still so much to do in this field of economics, because it is characterized by many facets that differ according to the context, the industry, the countries and many other variables. This leads to the impossibility of generalize as every situation can't be taken for granted and must be analysed separately and in depth. Through the literature review has been possible to being introduced to the topic of transfer pricing, with multiple and different points of view about it. It made it possible also to detect and figure out what has been the tendency followed by the most renowned academics and professors in the study of the subject throughout the years. Contrasting ideas and concepts have emerged, above all relating to the use of transfer pricing as a strategic tool implemented in the system of cost accounting or as an instrument to cope with tax issues.

In this sense OECD succeeded in clarify transfer pricing transactions by regularizing them. The methods proposed by the institution are today worldwide known and implemented, although they are not mandatory. They represent the starting point for many companies and MNEs approaching for the first time the concerns and troubles arising from its handling. Beside that, they are useful because they offer distinct methods covering more or less all the possible kinds of transactions, in this way being an option for every company. Although OECD Guidelines imposed themselves since their publication, transfer pricing models continued to be proposed, providing insights of case studies and new ways of dealing with transfer prices.

What result clear are the characteristics of what can be called a good transfer pricing, that are the preservation of the subsidiaries' autonomy, together with the capability for them to make a profit; another aspect is its perception of being right and fair for investment decisions and performance assessment, and also the ability to push subsidiaries towards the maximisation of group profits and the achievement of the overall goals in general.

With this work the hope is to shed more light on transfer pricing issues, through the illustration of the case studies which make it possible and easier to understand some dynamics related to the choice of the best method or to the preparation of the documentation. The first one of Marchesi Group showed the importance of the type of sector in choosing the method: the belonging to a capital-intensive industry led the group to opt for the Cost Plus method proposed by OECD, due to its higher suitability with respect to the other systems. Besides that, also the number and types of transactions have an influence, since the Romanian subsidiary, Marchesi Eastern Europe Srl, is not just a distribution centre, but it is actively involved also in the

manufacturing process. This leads to multiple transactions of raw materials, WIP goods and finished products, both from Fonderia Marchesi Srl to Romania and vice versa. What is really essential and one of the focus of the study is the fact that starting only recently to deal with transfer pricing represents for Marchesi Group an opportunity to build and reinforce its system of cost accounting, which previously did not appear to be structured and sufficiently adapt to support all the group, including the parent company and its subsidiaries. As a consequence, its strengthening resulted in the capability of adequately control costs, but also a tool to reduce them through a well-structured responsibility system and eventually a way to raise the turnover and make more profits.

The investigation of Eclisse Srl showed a different approach to transfer pricing with respect to Marchesi Group for some reasons: the company is not part of a capital-intensive industry and this meant that Eclisse selected a more appropriate method for its situation, namely the CUP method, suitable for transactions between a manufacturer, the Italian parent company Eclisse Srl, and a distributor, the Romanian subsidiary Eclisse Est. Indeed, the latter is not a manufacturer entity, but its responsibilities are limited to the distribution of finished products purchased from Italy, so there was just one type of transaction to analyse. Regarding the two aspects of transfer pricing, it does not seem to be a key element for the delineation of the cost accounting system, but just a duty to fulfil because imposed by the law. There is the possibility that it may have represented a strategic tool also for Eclisse Srl, when it first approached the matter, since who is talking, Stefano Spinetta, has been employed there for seven years and the group started to cope with transfer pricing back in 1996. This to say that he could have entered an already established and structured company, just adapting himself to the control and management of the documentation for example.

Although Eclisse Est is not one of the largest most active subsidiaries of Eclisse Srl, its analysis has been useful together with the one of Marchesi to understand which are the causes of the differences between them, going beyond industry dissimilarities. If we have to make a comparison between the companies, we can state that the amount of turnover or the global presence is not proportional and do not seem to go hand in hand with the complexity in managing transfer pricing. In fact, a group like Eclisse Srl, with a higher turnover, more experience and possessing more subsidiaries respect to Marchesi, has to face apparently simpler situation concerning transfer pricing (considering Romanian relationships). On the other hand, Marchesi has more to cope with, especially due to the different typology of the subsidiary and more possibilities related to the activities performed.

Lastly, this work delineates some limits: the two Romanian subsidiaries taken into consideration do not have the same importance for the two groups. In fact, Marchesi Eastern Europe Srl is an active and central participant in the transactions of the group, while, on the other hand, Eclisse Est maybe is the smallest (or one of the smallest) subsidiary controlled by Eclisse Srl in terms of volume of transactions. This leads to substantial differences when making a comparison. Besides that, the study considers only cases related to OECD and its methods, without proposing a company following its model of transfer pricing, and this would have been useful to examine in contrast to highlight strengths and weaknesses of each one.

Nevertheless, the hope is that this insight of transfer pricing can be helpful for others approaching the topic, as proposing case studies to analyse it in detail appears to be one of the most suitable ways to understand its dynamics and comprehend the reasons behind definite choices. As most of the existing economic issues, there is no universal solutions adapt for every situation, but analysis have to be carried out in order to capture the specific concerns.

GLOSSARY

The definition of some specific technical words taken from the OECD Guidelines that may result difficult to comprehend are listed below in order to have fully clear the ideas and concepts exposed.

Arm's length principle

The international standard that OECD member countries have agreed should be used for determining transfer prices for tax purposes. It is set forth in Article 9 of the OECD Model Tax Convention as follows: where "conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly".

Comparability analysis

A comparison of a controlled transaction with an uncontrolled transaction or transactions. Controlled and uncontrolled transactions are comparable if none of the differences between the transactions could materially affect the factor being examined in the methodology (e.g. price or margin), or if reasonably accurate adjustments can be made to eliminate the material effects of any such differences.

Comparable uncontrolled transaction

A comparable uncontrolled transaction is a transaction between two independent parties that is comparable to the controlled transaction under examination. It can be either a comparable transaction between one party to the controlled transaction and an independent party ("internal comparable") or between two independent parties, neither of which is a party to the controlled transaction ("external comparable").

Comparable uncontrolled price (CUP) method

A transfer pricing method that compares the price for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.

Controlled transactions

Transactions between two enterprises that are associated enterprises with respect to each other.

Cost plus method (CP)

A transfer pricing method using the costs incurred by the supplier of property (or services) in a controlled transaction. An appropriate cost plus mark-up is added to this cost, to make an appropriate profit in light of the functions performed (taking into account assets used and risks assumed) and the market conditions. What is arrived at after adding the cost plus mark up to the above costs may be regarded as an arm's length price of the original controlled transaction.

Functional analysis

The analysis aimed at identifying the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions.

Independent enterprises

Two enterprises are independent enterprises with respect to each other if they are not associated enterprises with respect to each other.

Multinational enterprise group (MNE group)

A group of associated companies with business establishments in two or more countries.

Multinational enterprise (MNE)

A company that is part of an MNE group.

Net profit indicator

The ratio of net profit to an appropriate base (e.g., costs, sales, assets). The transactional net margin method relies on a comparison of an appropriate net profit indicator for the controlled transaction with the same net profit indicator in comparable uncontrolled transactions.

Profit split method (PS)

A transactional profit method that identifies the combined profit to be split for the associated enterprises from a controlled transaction and then splits those profits between the associated enterprises based upon an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length.

Resale price margin

A margin representing the amount out of which a reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit.

Resale price method (RP)

A transfer pricing method based on the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. The resale price is reduced by the resale price margin. What is left after subtracting the resale price margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g., custom duties), as an arm's length price of the original transfer of property between the associated enterprises.

Traditional transaction methods

The comparable uncontrolled price method, the resale price method, and the cost plus method.

Transactional net margin method (TNMM)

A transactional profit method that examines the net profit margin relative to an appropriate base (e.g., costs, sales, assets) that a taxpayer realises from a controlled transaction.

Transactional profit methods (TNMM and PS)

A transfer pricing method that examines the profits that arise from particular controlled transactions of one or more of the associated enterprises participating in those transactions.

Uncontrolled transactions

Transactions between enterprises that are independent enterprises with respect to each other.

APPENDIX

QUESTIONNAIRE

I) Information about the respondent.

1. What is your current occupation?
2. How long have you been doing this work?
3. What is your current job level? (Owner, senior management, middle management, intermediate, entry level).
4. Where do you work? (Firm's HQs or division).

II) Demographic information about the company.

1. In what year was the company founded? By whom?
2. Who are the partners of the company?
3. In what state and city is the company currently headquartered?
4. How many employees work at the company?
5. How many divisions does the company have? Where are they located?
6. How much is the turnover? Has it grown through the years?
7. Who are your clients? (Retailers, privates, firms, etc.).
8. Does the company have a functional or divisionalized organization structure?

III) Cost accounting system and product pricing.

1. Have you adopted a job order costing or a process costing?
2. In assigning costs to the product, do you use the absorption costing or variable costing?
3. How many people are employed in the internal accounting? What competences do they have in common and are required to have?
4. How do you allocate the overhead cost? Do you use the ABC costing?
5. What are the main factors to consider when pricing products? (Target profit, customer demand, competition, differentiation, product life cycles, etc.).
6. What is the method used to price the final products? (Cost-plus method, target costing method, variable cost method, etc.).

IV) Transfer pricing information.

1. Are Romanian laws and regulations different from the Italian ones? If yes, in which way? Did you have problems the first time you faced the issue?
2. What type of TP do you use?
3. How did you choose your TP method? Which are the most important dynamics and aspects to take into account when establishing the TP?
4. How many people are involved in the process of choosing the right method? How long does it last? Is it time-consuming? And how complex is it?
5. Have you ever changed the TP method? Why?
6. Did the corporate history, power and evolution[8] have an influence on the choice of the TP method?
7. How much authority do you delegate to sub-unit/division managers? Are you able to strike a balance between providing autonomy to divisional managers and retaining some level of control to prevent dysfunctional behaviour? Are the divisions cost/profit/investment centres? If it is an investment centre, how do you measure its performance? (ROI, RI, profit margin, investment turnover, balance scorecard).
8. Do you (firm's central management) have complete access to divisional financial statements?
9. Do you work with goal congruence? And information asymmetry? Do you need to compensate units' managers in order to stimulate them to do well also at the firm level? And how much importance do you give to performance appraisal?
10. Do you decouple your internal TP from the external one used for tax purposes? Why? Why not?
11. How important is for you (firm's headquarters) the theme of innovation in your divisions? Is it important for you to measure it in the evaluation of international managers? How do you measure it?
12. Of the two main components of TP, which one is more important for you (the one you pay more attention to)? Why? Internal decision-making (cost and management accounting) and external use (report to tax authorities).
13. From an internal point of view, which aspect is the most important to consider for you?

[8] Can the divisions trust the parent company? Has this confidence grown through the years? Do these elements have an influence on other factors affecting TP choice?

14. Do you use transfer pricing as a strategic tool, or do you treat it just for tax management and compliance?
15. Have you ever had disputes or troubles with OECD or other institutions?

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