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The Impact of Transfer Pricing on Tourism Entities

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Abstract

The purpose of this document is desired to brought a significant contribution of the control activity, and to discuss new methods to ensure transparency and to eliminate constant disputes between the public and private sector. Starting with these aspects, we are looking to highlight international fraud as accompanying phenomena of transnational structures and economic relations, to explain its impact on the Romanian economy and to discus the key to finding the metholodgy to eradicate this phenomenon, and also to indicate our recommendations and opinions to what we believe is necessary to eradicate this phenomenon. Transfer pricing is basically the price used in the transfer of tangible and intangible assets and / or transfer of services between related parties, and this price should be based on market price without influence of the relationship of affiliation. For services or tangible assets, the transfer price comparison with the market is relatively easy to perform, but in the case of intangible assets, quantification of future benefits that it gives to an affiliated person, in comparison to a situation where this would be to an independent, is difficult to determine.

Key words: marketing, services, consumer, sale, tourism entity
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1. Introduction

The Government has considered, at least in theory and volitional way – that the fiscal policy and budgetary policy, is on one hand to balance the resources and expenses, and on the other hand to be based on the proper structure of both of these.

So, for internal resources for example, the problem is related to the correct establishment and accurately as possible for the proportion of internal resources from the public or private sector, depending on the ownership structure from the economy in order that it does not induce elements which can cause disturbances.

Therefore, public authorities can promote:

■ a fiscal policy that be handle equally all of traders, setting contributions in equal measure, which involves a fiscal treatment based on the principle of neutrality, which stimulates business improvements.

According to some opinions, this fiscal behavior would cause to minimize the chances for small businesses to penetrate the market;

■ a fiscal policy differentiated, according to clearly defined criteria, such as: size of traders, geography, economic branches, or other criteria to decide, if all these are to encourage business development, competition environment, or "could give a helping hand to" small businesses and "family" companies, and so on, in close correlation with the fiscal policies of the state in a historical moment well defined.

2. Materials and Methods

2.1. Transfer pricing

The term "transfer pricing" is used for transactions between related parties. Transactions which are not exclusive to the rules of the free market and therefore, can be influenced by other subjective factors, such as a policy of the group companies to minimize the cost of the taxes at the group level.

Transfer pricing is the price that a person or legal entity transfers goods (tangible or intangible) or services to a related party. Transactions between related parties must be made on the principle of market value - "the arm's length principle", without being influenced by the relationship or ‘congeniality’ between them.

According to the Fiscal Code the tax authorities can reconsider the transfer prices and, if necessary to adjust the income and expenses of those related parties involved into a transaction if that price has been deemed not to have been carried out at market price or that the price paid under the transaction has not been completed under the same or similar costs by independent persons.

2.2. Determining the transfer pricing

Determining the transfer pricing is made, in general terms, by comparing the prices that independent persons under comparable conditions would agree for the transaction. The taxpayers will have to assess whether there are significant differences from comparable transactions or persons and if they exist to adjust the difference as a result of the transfer prices being based on a functional analysis.

Functional analysis is to identify and compare the activities and the responsibilities assumed or that could be assumed by independent entities and related entities. In order to achieve the functional analysis, an important element is the structure and the group's organization.

Also, functional analysis will be performed by reference to the following issues:

- the economic importance of the functions performed by each related party involved in the transactions;
- sharing of risks and responsibilities between the affiliates involved in the transactions, because an increased risk assumed can be remunerated as such;
- the level, the type and the nature of assets employed which are or will be engaged by related parties involved in the transaction, like equipment, intangible assets, etc.

2.3. The transfer pricing file

The general legal regulations of the Transfer pricing file which must be prepared by the taxpayer is provided by the Fiscal Procedure Code, and the specific regulations about how to draw up the contents, deadlines, etc., of the Transfer pricing file were initially legislated in the Order of President NAFA no. 222/2008 (published in the Romanian Official Gazette no. 129/19.02.2008), legal stipulations taken over by the Order of President NAFA no. 442/2016 (published in the Romanian Official Gazette no. 74/02.02.2016).

It is worth mentioning that the requirements of national laws on the contents of the Transfer pricing file are harmonized and complying with the Code of Conduct on transfer pricing documentation for associated enterprises from the European Union (published in the Official Journal of the European Union no. C176 / 1 of July 28, 2006), which supplements the provisions of Order NAFA no. 442/2016. Also the Order NAFA no. 442/2016 shall be supplemented with transfer pricing guidelines emitted by the Organization for Economic Co-operation and Development.

Initially the Order NAFA no. 222/2008 provide that the Transfer pricing file must be prepared by taxpayers engaged in transactions with related companies and presented to the fiscal authorities at their request, request in writing during the course of a general or partial tax inspection.

In the Order NAFA no. 442/2016 are introduced new stipulations, distinct for presentation of the Transfer pricing file, according with to the size of the entity, the amount and type of transactions with related parties, respectively:

a) the entities from large taxpayers engaged in transactions with related parties with a total annual value of at least:

■ Euro 200,000 in the case of interest received / paid for the financial services;
■ Euro 250,000 in the case of transactions concerning of services received/rendered;
■ Euro 350,000 in the case of transactions concerning acquisitions/sale of tangible and intangible assets;

are required to prepare the File every year. The deadline for preparation of the Transfer pricing file is the set term for the annual statement of taxes and duties (usually March 25th of the following year).

Those taxpayers are required to submit the Transfer pricing file at the request of the tax authorities, during on a tax audit, but - with a novelty - we mention that this file can be requested by the tax authorities in the outside of an audit actions.

b) the entities from large taxpayers engaged in transactions with related parties with a total annual value less than the values listed above and other taxpayers categories of taxpayers SMEs (small and medium), carrying out transactions with related parties are obliged for preparing and submission of the Transfer pricing file only at the request of the tax authority, during a tax inspection actions. In this case the value of significance threshold is:

■ Euro 50,000 in the case of interest received/paid for the financial services;
■ Euro 50,000 in the case of transactions concerning of services received/rendered;
■ Euro 100,000 in the case of transactions concerning acquisitions/sale of tangible and intangible assets;

2.4. Methods for determining the transfer pricing

The following methods are recognized by transfer pricing guidelines distributed by the OECD:

■ the comparable uncontrolled price method ("CUP" method);
■ the cost plus method;
■ the resale price method;
■ the transactional profit split method;
■ the transactional net margin method ("TNMM").

3. Results and Discussions

Transfer pricing represents an opportunity and a threat, and their impact on businesses and of affiliated persons are important (https://www.transferpricing.ro).

The subject of transfer pricing over the last two years has become increasingly discussed and the tax authorities' attention in this area has a very important role in this field.

As it is presented above, in Romania justifying the transfer pricing by taxpayers is based on the Fiscal Code and of its implementing rules and specific national stipulations and also the OECD Guidelines on transfer pricing. In summary, according to these provisions, a taxpayer's transactions with related parties must be carried out in conditions of a free market and that a respectable business with good financial conditions would be expected to similarly agree between independent persons in comparable circumstances.

Study case: the Transfer pricing file by the Company Travel SA

◙ Company presentation

Travel Company S.A. is a tourism company, belonging to the International Travel Group INC.

Travel Company S.A. is a joint stock company, made in 1990, with the headquarters in Bucharest, Blvd. Primavera no. 88-103, Romania, whose main object of activity is (CAEN code: 5510) - "Hotels and other similar accommodation facilities".

Travel Company SA is certified in the tourism sector (TÜV Rheinland) by the Ministry for Regional Development and Tourism and the relevant entities from other European countries, such as: Germany, Belgium, Switzerland, Austria, France, Great Britain, Slovakia, Italy, Sweden, Hungary, Netherlands and Czech Republic.

By the way it uses the means within its reach, the tourism enterprise *„has to create a strategic advantage in the competition, positioning its offer in a way that makes it sharply different from its competitors, in the eyes of the consumers" Ph. Kotler (1998).*

◙ Financial dates

The main financial dates concerning Travel Group INC, consolidated for the period 2011 – 2015, are presented in the following table:

Financial information's	2011	2012	2013	2014	2015
Turnover	67.284	110.260	176.146	188.696	67.818
Net outcome	53.796	-8.922	-5.661	-14.004	-49.422
Total assets	196.523	118.285	171.875	188.541	146.404

Source: the author, after financial statements

◙ General description of transactions between related parties in the UE within Travel Group INC

Between 2011–2015, in the Group Travel INC were performed following main categories of transactions between related parties from European Union:

■ sale of tickets;
■ bookings;
■ sale of tourist packages;
■ sale of furniture and hotel equipment.

◙ The holders of intangible assets

All intellectual duties property related to the Group's products are owned by other related entities of the Group. Travel Company SA has no significant intangible assets and also does not pay royalties for use to the intangible assets from related entities.

In the field of the price policy, the Romanian tourism entrepreneurs can choose from a great variety of price strategies, differentiated by certain criteria, like: (Balaure V., Catoiu I. and Veghes C., 2005) the level and accessibility of prices, the specific characteristics of the market and the way of distribution. The strategies preferred by the tourism companies are mainly: the strategy of high prices, the strategy of intermediate prices, the strategy of low prices and the strategy of flat rate prices.

◙ Description of the transactions between related parties

In the period 1 January 2011 – 31 December 2015 Travel Company S.A. was involved in the following transactions with related parties from the group Travel INC.:

■ selling tourist packages by the Travel SA to the Travel S.A. INC – Austria;
■ selling furniture and hotel equipment by the Travel SA to the Travel INC – Germany.

◙ Choice of method of transfer prices analysis

After selecting the most appropriate method for determining the transfer price, the next steps consist in the application of that method for analyzing the compliance of the transaction/transactions tested with the principle of market value.

In order to test the compliance with the principle of market value of the transaction to sale the products by the producers to the them affiliates, applying net margin method, the following steps must be taken:

■ identification of the part which shall be the subject to the analysis (the test);
■ Development of a comparability study (identifying comparable companies with activities in the same field or a similar field and choosing one or more indicators of profitability);
■ setting a range of market value;

■ testing conformity with the principle of market values by comparing the profit margin applied by the test subject in the range of market value.

◙ **Identification of the part which shall be subject to the analysis**

In order to analyze the compliance of the tested transaction with the principle of market values, it is necessary first to select the related company which shall be subject to the analysis (the tested).

The tested Part is that participant in a transaction between related parties whose profits will be analyzed for compliance with the principle of market values.

After the functional analysis is carried out, we established the fact that producers are the least complex analyzed part from the prospective of the transaction, such failure marketing or sales functions and does not bear risks of market developments.

◙ **Comparability study**

Search strategy

According to The Romanian legislation, the initial search was done at local level, in companies based in Romania.

As they failed to identified comparable companies in Romania which can be used as reference comparability for producers, according to the provisions the Order of NAFA no. 442/2008 regarding the contents of the Transfer pricing file, we expanded our geographic search at the EU level.

Searching process involved the examination of the companies in the Orbis database, eliminate companies that do not meet the selection criteria and identify those companies that could be used as reference comparability for the sale of furniture and hotel equipment or similar products.

A summary of search strategy is presented in the following:

■ geographically criteria;
■ the activity code;
■ holding in the subsidiary;
■ stocks;
■ turnover;
■ negative operating result.

◙ **Selection the profitability indicator**

Profitability indicators used in this comparability study is the profit margin for the operating costs (operational cost), which shows to the profitability of a company by reporting to the value of the operational costs. This profitability indicator accurately reflects the profitability of a producer, considering the costs that it’s registered to add value to the products.

◙ **Setting the market range**

After identifying a set of companies with activities in the same field or a similar field comparable with those performed by producers and selecting an indicator of profitability, the next step consists in determining the market range. In compliance with the national law, the market range is defined as the interval between the lower quartile and the superior quartile.

The results of the companies selected in the final sample were calculated as a weighted average using financial data for a period of five years (ie 2011 – 2015) and are presented in the following table:

The margins of the operational costs (2011-2015)						
	No. of companies	**Minimum**	**The lower quartile**	**Median**	**The superior quartile**	**Maximum**
The final sample	11	1,56%	3,03%	3,75%	10,09%	12,92%

Source: the author, after financial statements

Profit margin for operating costs for independent companies included in the final sample for the period 2011 - 2015 range between 1.56% and 12.92%; the determined market range between 3,03% (the lower quartile) and 10,09% (the superior quartile) being determined by a median of 3,75%.

In accordance with the national law, this interval (ie between 3.03% and 12.92%) is considered to provide an relevant estimate on the value of open market.

◙ The compliance analysis with the principle of market values

■ the tested company's results

In the analyzed period, according to the methodology of transfer pricing, for selling finished products to related parties, the producers applied a profit margin of 5%.

■ the compliance analysis of the transaction tested with the principle of market values

After analyzing the compliance of the tested transaction with the principle of market values were compared to the results obtained by independent producers with limited functions and risks, included in the final sample applied to the profit margin of the Producer.

As can be observed from the analysis, the profit margin of 5% it stands in the comparison range (between 3.03% and 10.09%), which demonstrates that the transactions of the analyzed entities with the Group are in the market value, that in this case the transfer price which are applied in the Group respect the "arm's length" principle, which are not distorted by the influence of transfer prices.

4. Conclusions

The objective of this study was to determine if the Transfer pricing applied into transactions performed between Travel S.A. and its related parties, during the period 2011 – 2015, are based in accordance with the principle of market values.

To verify the compliance with the principle of market values in intra-group transactions performed by Travel S.A. was made for each type of intra-group transaction and involved:

■ understanding the economic context where it operates Travel Company S.A., which generated the necessity of the transactions;

■ analysis of the feasibility of applying for each method to transfer pricing assessment of market values in intra-group transactions performed, taking into account the circumstances and particularities of each type of intra-group transactions;

■ implementation of transfer pricing method selected for compliance of each intra-group transactions within the principle of market values.

Following the analysis, results that the intra-group transactions performed between Travel S.A. and its affiliates during the period 2011 – 2015 were held in the principle of market values, as it is defined in the OECD Guidelines and national legislation.

5. References

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- Kotler Ph., (1998). *Managementul marketingului* (traducers), Publisher Teora, Bucharest, pp. 181
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