The subject of the scientific work is analysis of the essence of the "transfer pricing" concept. It has been proven that transfer pricing is an economic and legal tool used by business entities for their tax burden optimization.

It has been concluded that the concept "transfer price" means the price generated by multinational corporations in the process of commercial activity between the affiliated companies located in different countries and, correspondingly, different tax jurisdictions. In essence, transfer pricing means intra-company pricing of goods transferred between the enterprise subdivisions located in different countries. Base erosion by means of transfer pricing can be performed not only based on the price manipulating by the affiliated companies, but also as a result of manipulating incomes and expenditures. The latter is accompanied by the financial resource withdrawal outside the national economy and its concentration in the low taxation jurisdictions.

Transfer pricing bears serious risks both for an individual country and for the world economy. Contractual freedom of transnational corporations and industrial and financial groups cannot be unlimited regardless of the principle of freedom of contracts in the private law relations. Economic activity of such business entities must subject to a strict control on the part of the country. In the process of transfer pricing tax control, the controlling state agencies are intended to prevent the decrease of tax liabilities by shifting the income to low tax jurisdictions by taxpayers.

**Keywords**
- transfer pricing, tax control, base erosion, tax competition

**JEL Classification**
- F1, F2, H2, H7

**INTRODUCTION**

The problem of transfer pricing tax control is becoming more and more relevant under the conditions of the world’s economy globalization, which became a reason of occurrence and successful development of multinational corporations (hereinafter – MNC). The transfer pricing mechanisms occurred in the second half of the 20th century simultaneously with the occurrence of large MNC and international trade intensification. Setting the transfer prices, MNCs have legal opportunity to avoid taxation.

Economic power of MNC reached global scope by the end of the 20th century. They account for more than half the production of world GDP, the total monetary reserves of MNCs are several times higher than the total foreign exchange reserves of all the central banks worldwide, moreover, multinational corporations are powerful employers. The most powerful 500 MNCs of the world have virtually unlimited economic power. Market capitalization of some of them exceeds USD 500 billion and annual sales amount to about USD 150-200 billion. These MNCs sale over 80% of electronics and chemistry products, 95% of pharmaceuticals, and 76% of machinery equipment (Becker-Ritterspach et al. 2017).
The provided statistical data enables us to state that MNCs control a relative share of all the international trade. The latter proves that the use of transfer pricing cannot only inflict losses to an individual country in the form of failure to pay taxes to state budget. Specifically, the issue of transfer pricing is jeopardized by the fact that using it, MNCs can determine or undermine international economy by means of redistribution of economic resources. It is necessary to mind that any MNC has its end beneficiary or a group of beneficiaries who make critical impact on it and obtain profit of its activity. In other words, groups of individuals are capable of making a significant impact on the stability of individual economy, affect the global economy generation. The above-mentioned factors stipulate an objective necessity of efficient tax control of transactions using transfer prices. This type of state control has already become one of conceptual conditions of national economy generation.

To illustrate the issue, it would be reasonable to provide the conclusion of Organization for Economic Co-operation and Development (OECD) that has focused the world’s community attention on the fact that in the present-day world it is impossible to consider a taxation system of any country separately from other countries’ tax systems in the context of determining the MNC tax liabilities (OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration, 2010). International Monetary Fund has also stated that trade globalization creates obstacles for national tax authorities in the use and, quite often, misuse of transfer prices for loans, dividends, goods and services, price of trademarks and patents by MNCs.

The objective of the article is the disclosure of the transfer pricing essence and justification of the necessity for efficient tax control of transfer pricing by the country.

1. LITERATURE REVIEW

In the worldwide practice, tax avoidance is usually called “tax planning”, which is an integral part of managerial activity. The use of transfer pricing is justified for the improvement of enterprise managerial efficacy. At the same time, each country limits the use of such financial tools in its own way setting the frameworks, beyond which such tax planning is considered the avoidance of tax payment. The purpose of the limit setting by the country is the increase of receipts from taxpayers by means of negative stimulation (Shtangret et al., 2013). Market price-based transfer prices for internally traded products are often used as a value measure for the decentralised management of internal production processes (Wolff, 2007). Using a survey of tax executives from multinational corporations, Klassen et al. (2017) documents that some firms set their transfer pricing strategy to minimize tax payments, but more firms focus on tax compliance.

Analysis of theoretical sources and applied researches confirms that there is a problem of adequate approaches to transfer pricing, which serves simultaneously as an international tax strategy and a tool for maximizing the profitability of MNCs (Cherevko, 2014). Transfer pricing is described as one of the methods of pricing of goods and services that are distributed within one multinational company (Carmo, 2015). The approach of Velloso and Muller (1992), considered to be the classic one, presupposes that transfer pricing is manipulating the expenses, income and losses in transactions between the related entities in a manner different from the one which would be used in operations performed under normal market conditions, in order to obtain tax benefit. The United Nations defined the term “transfer pricing” as a general concept used to denote pricing for intra-group, cross-border transfers of goods, intangibles and services (United Nations Practical Manual on Transfer Pricing for Developing Countries, 2013).

Transfer pricing in the general sense is the process of establishment the in-house prices (so-called transfer prices), where goods, services, money and other assets are transferred from one business unit to another, as well as the following calculation of the financial result of each business unit in consideration of these transfer prices. Sometimes these operations are not carried out directly between units, but via special intermediary units (transfer
centres) (Shtanhret et al., 2013). At the same time, in economic and legal literature transfer pricing is often defined as distortions of contractual price or distribution of incomes or losses to minimize the tax burden (Shtanhret et al., 2013; Cherevko, 2014, Tkachyk, 2015). Regional aspects of taxation in EU counties and possibilities of their harmonization are represented in a number of scientific works (Feranecova et. al., 2017; Hull et al., 2005; Shtanhret et al., 2013).

2. METHODOLOGY

In the article common scientific and special methods of knowledge of economic processes and phenomena are used: dialectical, analysis and synthesis while defining concept of transfer pricing and its implication in the world and in Ukraine, comparison and generalization in order to describe transfer pricing methods and approaches to transfer pricing regulation. Besides, means of formalisation method was implemented to show the features of each transfer pricing control method and its possibilities for usage in current economic situation. Scientific works of domestic and foreign scientists, analytical reports and statistical data of international financial organizations represent information base of the research.

3. RESEARCH RESULTS

Transfer pricing can be reasonably considered as an economic and legal tool used by business entities for optimization of their tax burden. Price manipulation may provide significant tax benefits to business entities on condition that it is implemented within the legal framework (Tkachyk, 2015). However, the state incurs losses due to tax planning because tax payments do not go into the budget in full. Consequently, the use of transfer pricing results in avoidance of disclosure of their real incomes by taxpayers that undermines financial potential of the national economy.

In this regard, Cherevko (2014) points out that transfer pricing is a method of resources redistribution and taxation optimization that affects distribution of income, profits, risks and quality of life. Managing transfer pricing is intended to provide better coordination and regulation of relations between economic variables, reducing total costs, increasing employees’ motivation.

Thus, the contractual freedom principle is the driving source of private legal relations because it grants its participants the right to determine all contractual terms and conditions, including price, at their discretion.

Thus, generally, individuals are free to determine the price of goods, works and services. Usually business entities pursuing profit provide market price in the contracts with their contractors. At the same time, through transfer pricing tools the parties may abuse their right to freely determine the price of the contract, deliberately overstating or understating price. The latter is aimed at the base erosion and, consequently, tax avoidance.

In this regard, it should be admitted that the structure of the tax systems of most countries is largely based on the taxation of the companies’ financial results. The amount of income affects the amount of corporate income tax base, value added tax base, capital gains tax base. In turn, the profit is generated based on the amount of income received and the amount of the expenses incurred. The prices, at which transactions are performed, are a key factor affecting the amount of revenues and expenses. Therefore, pricing provides large opportunities for profit distribution between the dependent organizations, and such distribution is carried out in a way that is the most profitable for the holding as a whole (Karnaukh, 2015).

Using transfer pricing ensures legal tax base “optimization”. The latter is accompanied by the withdrawal of funds outside the national economy and their concentration in low tax jurisdictions. It is clear that transfer pricing has negative impact on the national economy of the state, which does not receive a great amount of resident’s tax revenues.

Multinational corporations are characterized with an extensive structure of legal entities in different countries, and all those entities are directly or indirectly controlled by a single centre. That is why they are interrelated, and therefore may establish favourable conditions of transactions performed within MNCs. In this way, the income of individ-
ual MNC legal entities is distributed, which may be stipulated by different tax regimes for individual incomes, individual legal forms of business entities, the provisions of bilateral double taxation agreements and tax systems of different countries. While transfer pricing does not affect the profits of MNCs, it directly determines redistribution of profits of legal entities within the group (Thompson, 1995).

Shtanhret et al. (2013) provided profound structuring of the features that are usually peculiar of MNC: 1) generation of a system of international production, which is distributed in many countries, but is controlled from one centre; 2) high intensity of intra-corporate trade between branches located in different countries; 3) relative independence in making operational decisions both on the home country and on the receiving country; 4) global structure of employment and staff mobility between countries; 5) development, transfer and use of advanced technology within the closed corporate structure.

Taking into account the abovementioned, we can make a conclusion that the concept “transfer price” means the price generated by a MNC in the process of its business activity between the affiliated companies located in different countries, and consequently, different tax jurisdictions. In essence, transfer pricing means intracompany pricing for products moving between the subdivisions of enterprises located in different countries. That is, transfer pricing means price establishment in the transactions between the companies of the groups.

Therefore, we agree with Raymondos-Moller’s & Scharf (2002) thesis that transfer pricing legal regulation may be accompanied by tax competition between states where the MNC units operate. The latter is quite natural, since a MNC gains income from its activities in various tax jurisdictions. Naturally, MNC will always strive to pay taxes in the country where a lower income tax rate is established.

Due to tax competition between states and since the transfer pricing is closely related to negative phenomenon of profits manipulation by affiliated enterprises and lack of significant funding, world community has developed a system for preventing, detecting and eliminating phenomenon of “arm’s length principle”. This “arm’s length principle” reflects economic realities of specific facts and circumstances for transactions of taxpayer under tax control, and takes as a norm the regular functioning of market as the basic value. It enables to approach open market standards, when goods and tangible or intangible assets are transferred or services are provided between interrelated enterprises (Romaniuk, 2013). The purpose of “arm’s length principle” is to provide an adequate tax base in each jurisdiction and avoid double taxation. The main methods of transfer pricing used by OECD countries are represented in Table 1.

OECD also pointed out that the use of transfer pricing may be stipulated not only by MNC tax considerations, but also by other factors, such as currency exchange control, anti-dumping duties introduction, state regulation of prices, requirements related to cash flow in enterprises within a group of related parties, pressure on the part of shareholders interested in high level of profitability on the level of the parent company (OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration, 2010). In specialized literature, other reasons of transfer prices application may be found. For example, the distortion of the purchase price of goods or services from abroad may be aimed at evasion of the currency regulation rules or other rules governing the profit repatriation. Another reason of transfer pricing may be the considerations of financial management as a means of improving the efficiency of financial resources utilization and the increase of managers’ personal responsibility (Buckley & Hughes, 2001).

Along with the above, the reasons of transfer pricing application can be the legitimization of proceeds of crime (Bhattacharjee & Moreno, 2017). Such money laundering is explained by the fact that illegal sources of funding the foreign economic activity is unlikely to be detected. It should be added that the most common source of illegal funds laundered by means of transfer pricing are: 1) revenues derived from traditional forms of criminal activity; 2) income from misuse of state budget costs and state loans.

Thus, transfer pricing may have various reasons. However, in any case, the main reason of transfer pricing is the tax considerations that lie in the
We may agree with the position of Nepesov (2007) that the main purpose of transfer prices is the “transfer” of the tax base to an affiliate, located in a more favourable tax or other administrative regime. These are the various tax preferences, including the offshore resident status, tax holidays, the application of preferential tax rates, and the right to use other tax benefits. This transfer is usually accomplished by transaction price manipulation.

### Table 1. Transfer pricing methods of OECD countries

<table>
<thead>
<tr>
<th>Method</th>
<th>Main scope of application</th>
<th>Basic parameter</th>
<th>Application of “arm’s length principle”</th>
<th>Degree of use of OECD countries</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Traditional transaction methods</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Comparable uncontrolled price method</td>
<td>The widest use in the presence of a comparable transaction and price information in this transaction</td>
<td>Price</td>
<td>Direct and most consistent use</td>
<td>Most recommended for use</td>
</tr>
<tr>
<td>Resale price method</td>
<td>When analysing the transfer pricing, salesperson of the product is an independent company</td>
<td>Resale price margin</td>
<td>Direct use</td>
<td>Recommended for use</td>
</tr>
<tr>
<td>Cost plus method</td>
<td>In the analysis of transfer prices of the supplier of products to an associate</td>
<td>Cost plus mark up</td>
<td>Direct use</td>
<td>Recommended for use</td>
</tr>
<tr>
<td><strong>Transactional profit methods</strong></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Profit split method</td>
<td>If there is no data for application of traditional methods</td>
<td>Profit split method</td>
<td>Indirect use</td>
<td>Used, if traditional methods are not applicable</td>
</tr>
<tr>
<td>Transactional net margin method</td>
<td>In case of the data absence for the application of traditional methods</td>
<td>Net margin</td>
<td>Indirect use</td>
<td>Used, if traditional methods are not applicable</td>
</tr>
<tr>
<td><strong>Other methods</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Global formulary apportionment</td>
<td>An alternative to methods that apply “arm’s length principle”</td>
<td>Fixed formula for calculating transfer price</td>
<td>Not applicable</td>
<td>Not used</td>
</tr>
</tbody>
</table>

3.1. MNC as a main subject in transfer pricing

Transfer of MNC’s profit to a low tax jurisdiction results in receiving insufficient amounts of taxes that had to be paid by the entities and the state. In other words, because of tax rules, which make it possible to reduce the tax base due to price manipulation, the state receives less tax payments than expected provided market price application by the taxpayers. Moreover, the states might incur losses due to evasion of mandatory norms of customs and anti-monopoly laws by MNC.

Therefore, countries need correct assessment of taxable income of each MNC subdivision, which can exist both in the form of an independent legal entity and in the form of a permanent establishment. In general, the idea of the state regulation of transfer pricing is to limit the freedom of the parties to determine the contractual price, aimed at correct tax calculation.

The foregoing should be supplemented by the conclusion of Cherevko (2014) that transfer pricing is used mostly by highly developed countries and the less developing countries are mainly the receiving party. It is due to the fact that most MNCs are based in developed countries, and the developing countries are the receiving party. Therefore, unfair transfer prices result in the transfer of financial resources from the second group of countries to the first one, generating even a greater gap in economic development. The latter clearly illustrates the negative impact of transfer pricing on international economies.

Implementing transfer pricing regulation, the state should rely on the principle of balance between public and private interests. In any case, the degree of state intervention should be clearly defined on legislative level. The purpose of public legal regulation of transfer pricing is taxation of the income of the taxpayer that has actually gained the corresponding financial result or that would
have the right to gain it, if it had not been for the reasons to minimize the tax base. With regard to this fact, Nepesov (2007) has appropriately underlined that the main purpose of MNCs’ profits distribution in general is the provision of a fair share of the tax base for each tax jurisdiction within which the relevant MNC subdivision operates.

In this case, transfer pricing can play a dual role in the relationships between a MNC and host or home country. On the one hand, favorable tax regime may be a key factor of foreign investments attraction. It is beneficial for both, as MNC is able to minimize its tax base, and host country, in turn, acquire investments of vital importance. For example, the recent economic freedom indices rating indicate that at least half of top 10 countries have signs of a tax haven. At the same time, home country of such a MNC, whose tax system is not so favourable for profit, suffers from the flight of capital. What is more, this capital is exported in an implicit form, which complicates the control and regulation of this process.

Clearly, in case of legal regulation of transfer pricing, taxation of profit of such multinational corporations with commercial presence on the territory of several tax jurisdictions is considered. The states, from which the tax payments outflow, are interested within the framework of efficient legal regulation of transfer pricing. The essence of such regulation is that for the purpose of efficient taxation of MNC’s activities, states set pricing rules for transactions between the related parties. In case of violation of these rules, liabilities of taxpayers must be revised by authorized state bodies. However, it should be noted that transfer pricing may occur not only due to foreign economic activities of MNCs but within one state as well. Transfer pricing may also be applicable in relations between the interrelated residents of the same tax jurisdiction.

3.2. Transfer pricing practice in Ukraine

In practice, ways of implementation of transfer pricing may vary. Application of methods of transfer pricing for minimization of tax liabilities in Ukraine is examined below (Vakulchyk & Riabich, 2014):

1) Ukrainian companies that are a part of commercial and industry groups export the manufactured products to related parties located in low taxation jurisdictions at the prices almost similar to the costs of production, and the related parties, in turn, sell them to customers at market prices. In this case, most of the profit from the sale remains abroad, Ukraine does not receive tax amounts in full, and the revenues in foreign currency do not come to the national banking system;

2) distributors of international companies import the products of foreign manufacturers to Ukraine, overstating the price, which in turn reduces profits of Ukrainian company from the resale of such goods to domestic buyers, and, consequently, the amount of taxes payable to the budget. The generated difference remains in the country from which such goods have been delivered;

3) application of transfer pricing in the domestic market. First, many Ukrainian enterprises apply preferential tax regime (for example, agricultural entities). Second, within the years of stagnation, enterprises accumulated considerable tax losses, which allows them not to pay taxes now. Such companies may become agents for transactions that result in profit shifting.

One of the most common ways of application of transfer prices in the world is to move the tax base to the trading company which is an affiliate of the manufacturer. This may be implemented by means of sale of manufactured goods at underestimated price in favor of a trading company, and the latter, in turn, sells the obtained goods at normal market prices. The classical model of transfer pricing provides export of goods at low (non-market) prices, which makes it possible to minimize tax and customs payments to residents and, simultaneously, accumulate the difference between the declared and world prices on the accounts of the controlled foreign companies. Typically, the products are exported to affiliated companies registered in offshore jurisdictions with preferential tax burden. Finally, an affiliated foreign company sells products at the world market prices, and the profit remains at its accounts.
Base erosion by means of transfer pricing is possible not only by price manipulation exercised by affiliated companies, but as a result of incomes and losses manipulation as well. Thus, one of the methods of transfer pricing is using the agreements without prices or agreements where the sale of goods, services or intangible assets, the price of which could be verified, is not performed in the process of execution. For instance, in the world practice, the institution of cost allocation agreements is widely used, where such cost allocation agreements are defined as agreements executed for allocation of costs and risks related to joint development, production or acquisition of assets, services or property rights between the parties and establishment of the share of each party’s participation in the respective assets, services or rights (Nepesov, 2007). The use of cost allocation agreements may be stipulated exclusively for tax reasons, since it allows the parties to transfer the proceeds in favour of the party in a more favourable tax jurisdiction.

As we can see from the above, transfer pricing carries serious risks both for a single state, and for the global economy. The contractual freedom of transnational corporations and financial-industrial groups may not be unlimited, despite the contractual freedom principle in private law relations. Economic activities of such entities should be subject to state tax control. The latter is especially important for Ukraine, where transfer pricing has been quite successfully used ever since the proclamation of independence.

In this context, it is appropriate to provide the findings of the State Service for Financial Monitoring in Ukraine, which pointed out that the main illegal schemes in export-import transactions, which are the following:

1) the use of foreign economic transactions for capital withdrawal from Ukraine: fictitious import contracts (“pseudo-import”); export at low prices; import at high prices.

2) the use of foreign transactions for generation of groundless VAT credit and illegal VAT offset and evasion of its payment: the use of fictitious export contracts (“pseudo-export”, “non-typical” export); the acquisition of goods subject to export at high prices using fictitious companies; import at low prices.

3) the use of foreign transactions to obtain tax benefits (The current methods and ways of legitimization (laundering) of proceeds of crime, 2012).

The current state of affairs in the field of transfer pricing in Ukraine is the result of a number of objective and subjective factors, which can be classified to social, economic, organizational and normative (Table 2).

We may observe that actually all of the export-import transactions of the residents of Ukraine involve transfer pricing. The process of transfer pricing in foreign economic activity of residents should be the subject of special attention of tax control authorities. The purpose of transfer pricing tax control is to monitor application of transfer pricing and prevent tax evasion and state budget laundering.
CONCLUSION

To summarize the above doctrinal approaches and regulations, we will point out the most common ways of transfer pricing application by MNC to evade taxation:

1) transfer of tax base to affiliated companies incorporated in low tax jurisdictions by means of exporting goods, works and services at low (transfer) prices;

2) erosion of tax base by means of import of goods, works and services to the domestic market at overestimated prices, and their subsequent resale to customers at normal prices;

3) application of transfer pricing in the domestic market with the affiliated companies that get advantage of tax preferences;

4) contracts with non-existing companies or affiliated “shadow companies” that further terminate their activities and do not pay taxes;

5) signing contracts between affiliated companies without prices or contracts, where the sale of goods, works and services the price of which could be verified, is not performed.

The system of transfer pricing monitoring in Ukraine and other countries lacks consideration of subjective aspect of business transactions by controlling bodies. The tax authorities need to focus on defining the motives and objectives of the transaction at relatively low cost, because if the company, for objective reasons, has lower prices and no intention of avoiding taxation or erosion of tax base, then there is no reason to levy additional payments. Therefore, it is important to consider financial results of the transaction, and not just their prices.

Inspection of prices in controlled operations by regulatory authorities is a very complex and extensive process that involves accounting, financial, economic analysis and inspection of comparable transactions. The complexity of transfer pricing tax control is worsened by the fact that the law has no specific rules or guidelines concerning the requirement of adjustments in respect of a particular transaction. The key factors that have a material effect on the price of goods (works, services) or taxpayer’s income tax must be determined in each case. Anyway, the commercial and financial conditions of the similar transactions between unrelated parties may be considered comparable by the supervisory authorities only on conditions that the differences between them have no significant effect on the transactions outcome, or can be eliminated by adjusting the conditions (results) of the comparable or controlled transactions. It should be considered that in various markets there might exist different prices corresponding to the “arm’s length principle” even for transactions with similar goods (works, services). In view of these facts, for objective comparison, it is necessary that the markets where the independent and associated entities operate have no differences that significantly affect the price.

In the process of transfer pricing tax control, state supervisory authorities serve to prevent underestimation of tax liability by means of profit shifting to low tax jurisdictions by taxpayers. To prevent abuse of transfer prices, the state establishes the following administrative and legal restrictions of taxpayers’ business activity:

1) it defines a “matrix” (criteria) of controlled operations, identifying specific business transactions of taxpayers as controlled ones, that is, those carried out by related parties;

2) approves the list of low tax jurisdictions (offshore areas);
3) sets the maximum threshold of transfer (domestic) prices deviation from the market ones in the controlled transactions;
4) sets indicative prices;
5) sets limits of the amount of expenditures, by which the income may be reduced;
6) determines the accounting documentation for the transactions with affiliated (related) entities to be annually submitted by taxpayers to regulatory authorities.

Unfortunately, in Ukraine, as in other post-Soviet countries, tax control of business operations primarily is aimed for adjusting the tax base and restoring tax payments that have not been received due to a variety of transfer pricing schemes. However, from the experience of countries of OECD, it should be mentioned that such control should be channelled on solution of issues related to saving of manageability of both active assets (primarily capital) and resources (in particular, measures of export operations of sale of commodities). Besides, tax authorities of Ukraine should exercise control not only in accordance with legislative requirements, but also evaluate true intentions and results of economic, investment and financial activities. According to this fact, the definition of tax control should not be only within the sphere of compliance with the procedure, which is defined in tax legislation. In fact, tax control should implement more functions than those stipulated in the Tax Code of Ukraine and should be enshrined in the state economic policy.

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