New OECD Transfer Pricing Guidelines Will Help Multinationals Better Tell Their Stories to Tax Authorities

Over the past several years, transfer pricing has gained international spotlight. Many high-profile companies have made headlines because of transfer pricing disputes with tax authorities involving billions of dollars.

Definition: "A transfer price is the price charged between related parties (e.g., a parent company and its controlled foreign corporation) in an inter-company transaction." While transfer pricing policies, as well as tax rates, may differ between countries, compliance is required in 70 countries, making transfer pricing an international concern for any company that expands its operational and marketing presence beyond its borders. ***Source: Journal of Accounting.***

There is a large amount of taxes at stake (and competition between countries to collect their share). In addition, there are complex tax regulations from one country to the next and a large volume of data that needs to be amassed to determine the proper amount of transfer pricing. Because of that, multinational enterprises (MNEs) across the globe are struggling with this issue as they face a materially increased compliance burden. Their struggles centre around two key issues:

1. How transparent do we want our financial information to be viewed by local tax authorities?
2. How can we become more efficient at collecting data to meet the growing demands of local tax authorities?

These struggles correspond with a new development in the world of transfer pricing. To create a better framework that will allow clearer communication between local tax authorities and MNEs, the OECD has announced recommendations for transfer pricing documentation in September 2014.

The intent of the announced guidelines is to reach a common approach for transfer pricing documentation that can be adopted by all countries. The draft of the OECD proposal calls for a three-tier approach: MNEs prepare a global master file, local files for each country in which they operate, and separate financial information on a country-by-country basis for disclosure to tax authorities. The OECD's proposal reflects concerns voiced by its member organisations that current tax return and transfer pricing documentation guidelines are insufficient in identifying and evaluating transfer pricing results as reported by MNEs.

The real story behind the OECD guidelines is that MNEs do not want to be double taxed. With clearer guidelines, MNEs that already excel in their global documentation should have fewer issues in explaining their transfer pricing decisions to local tax authorities. For these organisations, the OECD guidelines and the call for more documentation is welcome news. For companies that have not yet shared the details of their operations or have not invested in the practices and technology to produce world-class transfer pricing documentation, the OECD guidelines may be perceived as a costly burden. Companies that have carefully thought through how they want to present their story to tax authorities are already in compliance with most of what the OECD is proposing. Now, they can focus on how to make that process of data collection and reporting more efficient. For companies that don't have a game plan, the OECD guidelines will provide the structure to start elevating their processes.

There are three essential goals behind the OECD transfer pricing announced guidelines. These include:

1. Ensure that MNEs appropriately consider an arm's length standard when setting intercompany transactions;
2. Companies need to provide tax authorities with a consistent global overview and country-specific information to conduct an informed transfer pricing risk assessment and;
3. Companies must provide tax authorities with the information they need to conduct a thorough audit of specific intercompany transactions relevant to that tax authority.

While the OECD announcement calls for a world-class standard in transfer pricing, reporting is truly the start of a deeper dialogue about establishing new standards. As part of the review process, the OECD has posed several questions about transfer pricing, which include:

1. Should the template be based instead on a "top down" approach, which allocates overall income among various affiliates?
2. What are the additional systems requirements and compliance costs of each approach?
3. Should the template be based on an entity basis or a consolidated country basis?
4. Should the global information be reported in US GAAP, IFRS, or local statutory financials?

CHALLENGES AND OPPORTUNITIES

For MNEs, the OECD guidelines have a number of implications, which include:

- **Increased transparency.** The primary intent of the OECD recommendations is to increase transparency in international taxation. Therefore, companies will need to become more comfortable documenting details on their business operations. Some corporations may find this difficult based on current transfer pricing strategies (i.e., placing profits in known tax havens).
- **Develop a game plan.** In the 2013 Thomson Reuters Transparent Tax Survey, Thomson Reuters, in partnership with the Chartered Institute of Management Accountants (CIMA), learned that only 35 percent of today's global organisations have or are planning a tax transparency strategy, based on responses from the heads of tax at more than 100 global companies. Based on the detailed reporting called for in the OECD guidelines, companies should consider developing a high-level strategy about how to present its transfer pricing story to tax authorities both globally and locally. Companies that do not develop a strategy risk not only bumping heads with tax authorities, but damage to their global reputations by being perceived as hiding profits in tax havens.
- **Prepare now: Upgrade information technology.** To comply with the new OECD standards, it may be necessary for some companies and/or their foreign subsidiaries to upgrade their information technology systems to make the process of collecting and reporting data more efficient and productive. Under the OECD guidelines, organisations should carefully examine their current process to collect qualitative information and how they are presenting financial information as it relates to intercompany transfer pricing policies.

TRANSFER PRICING COMPLEXITIES

The complexity of transfer pricing is not limited to just the number of countries that a particular company operates. A number of other factors are at play as companies struggle with transfer pricing issues. These include:

- The number of transaction types
- The desire to minimise risk, which is inherent in manual processes
- The lack of efficiencies involved in the manual collection and reporting of data to comply with transfer pricing policies
- The pressures of meeting compliance expectations with fewer resources

"What it boils down to is value," said Tracey Rossow, an attorney specialising in transfer pricing with Thomson Reuters Tax & Accounting division. "When a company can go beyond the mechanical aspect of the transfer pricing calculation process and have time for analytics – understanding why a particular subsidiary isn't earning an appropriate profit – that changes the activity to a value add. Being able to create models for alternative methodologies can provide the transfer pricing team a valuable tool to help businesses make better business decisions."

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TECHNOLOGY SOLUTIONS DELIVER DATA CONTROL THROUGH CENTRALISATION

To meet the growing compliance burdens of the draft OECD proposal, MNEs should consider embracing an end-to-end solution to handle the collection of data and the processing of reporting documentation.

To enact country-by-country reporting and defend audits, ONESOURCE Operational Transfer Pricing is one tool that MNEs may want to consider. This powerful software application can assist companies in enhancing the efficiency of its data collection by centralising the data at the appropriate level of detail for transfer pricing purposes and applying a company's transfer pricing policies to that data in a consistent manner to meet the global documentation standards proposed by the OECD.

"Many companies struggle with having access to the appropriate level of data," said Rossow, "and often, it is the responsibility of a local controller to provide them information, such as segmented financials. Because the underlying detail isn't provided, when an audit does occur, the transfer pricing team often struggles with understanding the detail behind the previously provided financials, and is put at risk in providing sufficient detail to meet the demands of government auditors."

Centralising data is a critical component of transparency. Many corporate tax departments do not have access to all of the data at the appropriate level of detail, so they must rely on local controllers to provide that data. Without being able to drill down into the details, they may not be able to comprehend, for example, whether indirect expenses were allocated appropriately across products in the manner dictated by the company's transfer pricing policy. ONESOURCE Operational Transfer Pricing gathers US GAAP, IFRS, and local statutory information into one system that can be leveraged for all of your transfer pricing needs.

By centralising data with the ONESOURCE Operational Transfer Pricing tool, all stakeholders within the process have access to the results, with controls over who can access the data, so one controller can't see the financial results of another controller's entity. This increases confidence within a company that their transfer pricing policies are accurate while minimising any year-end adjustments because the company has the ability to make adjustments throughout the year to ensure compliance with the arm's length principle. In the process, a company's risk is significantly reduced.

LOOKING FORWARD

As various countries become more sophisticated in their use of technology to manage the transfer pricing process, we believe government auditors will request even more detail in the years ahead. In addition, they think that government auditors will introduce modeling and data mining to the process to ensure greater compliance and more accuracy. For MNEs, it will be key to stay one step ahead of tax authorities as those officials become more knowledgeable and efficient at the process.

ONESOURCE Transfer Pricing offers a complete solution for local file, master file, and country-by-country reporting. With access to more than 1.6 million private and public company records, ONESOURCE Transfer Pricing can provide product/price comparables that allow MNEs to establish and defend a transfer price. ONESOURCE also provides access to high quality public, private, and intangibles data for transfer pricing analysis, and it allows an organisation to evaluate its existing pricing and policies against the latest data to create, implement and track new policies and manage and communicate policies across your business.

"Without technology, companies that continue to rely upon manual processes will struggle to comply with those requests," Rossow said. "Companies should carefully analyse where they're at today and begin to introduce technology that will keep them one step ahead of tomorrow's government auditors."

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