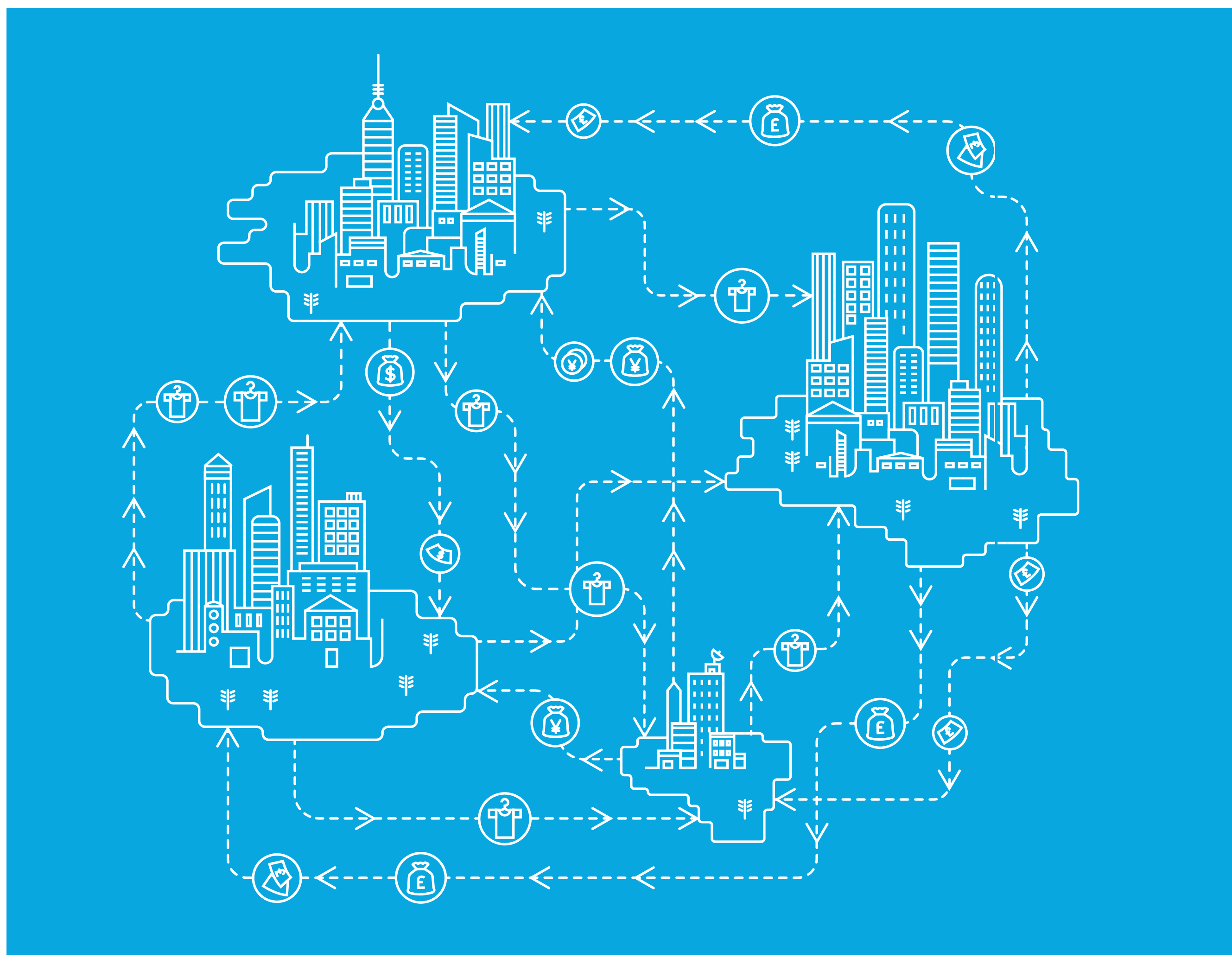
Managing your transfer pricing life cycle

From planning to implementation, a practical approach for middle market enterprises



TRANSFER PRICING: COMPLEX CHALLENGES, VALUABLE OPPORTUNITIES

Transfer pricing is a complex but imperative risk management endeavour for any international enterprise. For internationally active middle market companies, transfer pricing can be especially daunting because it is interconnected with so many other aspects of the business, including commercial operations and other tax objectives. You simply cannot consider transfer pricing on its own.

Plus, the same complex regulations apply regardless of the size of your business, and those regulations are subject to change. Look no further than how the Organisation for Economic Co-operation and Development (OECD) has continued its work to address base erosion and profit shifting (BEPS)—arriving at a framework commonly referred to as BEPS 2.0. Simply staying up to date on evolving laws and regulations requires significant effort.

The OECD and members of its inclusive framework are grappling with how to adjust tax systems to address the challenges of an increasingly digital economy. Countries everywhere are redoubling efforts to ensure value created within their borders is appropriately recognized and taxed. In an environment of heightened transparency and disclosure, international enterprises face enhanced tax risks associated with their transfer pricing decisions.

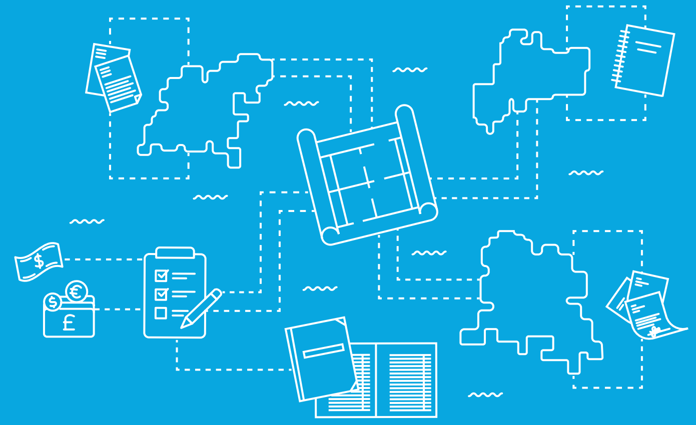
Global growth requires continually adjusting to transfer pricing challenges as you pursue opportunities in new markets. This guide breaks down those challenges into discrete steps, providing middle market companies with guideposts to direct an effective, efficient and sustainable transfer pricing operation. From planning to operational transfer pricing, our transfer pricing professionals share lessons and best practices from their extensive experience. By adhering to these guideposts, transfer pricing can become an effective tax planning opportunity for any enterprise operating in multiple tax jurisdictions.

WANT TO LEARN MORE?

RSM debunks common misconceptions companies have about transfer pricing.

GUIDEPOST ONE: PLANNING

Controlling risk, capitalizing on opportunity



An effective transfer pricing plan helps you evaluate risks and opportunities. Developing one requires understanding your intercompany activities and your transactions between the various jurisdictions in which you operate. It will help you identify relevant stakeholders and associated effects on your intercompany flows, which is essential in integrating transfer pricing into the tax governance of your organization.

MAPPING YOUR TRANSFER PRICING FOOTPRINT AND TRANSACTIONS

Middle market companies rarely have the time or resources to ensure 100% compliance with transfer pricing requirements globally; therefore, a strategic approach is key. Mapping your transfer pricing footprint is essential in assessing your transfer pricing risk and opportunity, enabling you to prioritize and deploy resources appropriately. Follow these steps to acquire the information necessary to create an effective and targeted transfer pricing plan:

1. **Determine your footprint and the regulatory issues associated with each jurisdiction.** In which countries do you operate, and what transfer pricing rules and regulations apply? In those jurisdictions, what is your transfer pricing audit history? What are the potential transfer-pricing-related penalties that may apply? What are the tax attributes of each entity, such as losses, effective tax rates and tax holidays?
2. **Inventory your transactions.** Define the functions, risks and intangibles involved in your intercompany transactions. Include tangible goods transactions; intercompany loans or financing arrangements; royalty payments; and shared services costs, such as human resources, information technology, accounting and legal services.
3. **Determine the associated direct and indirect tax implications of your intercompany flows.** Which intercompany transactions are subject to withholding tax, value-added tax (VAT) or customs duties? Which transactions affect your global intangible low-taxed income (GILTI) or your Base Erosion and Anti-Abuse Tax (BEAT) liabilities?
4. **Assess your current transfer pricing documentation.** Do you have all the information you need to identify and evaluate your intercompany transactions accurately? Is your documentation sufficient to support your transfer pricing policies? When was your last transfer pricing study prepared?

> A thorough understanding and evaluation of facts serve as the foundation of a strong transfer pricing plan.

WANT TO LEARN MORE?

Considering implementation at the very beginning of the process will help you accomplish the hard work necessary after completing your transfer pricing study. "How to implement your transfer pricing study" explains how a study provides the economic analysis necessary to support your transfer pricing decisions in the event they are challenged by the IRS or another tax authority. This article also explains how to implement your study as part of your overall transfer pricing effort and how to overcome common implementation issues.

ASSESSING YOUR RISKS

An effective transfer pricing plan reflects the fact that intercompany transactions carry different levels of risk. Informed planning requires accurately identifying your risks, gauging the cost of addressing them and potential penalties, and prioritizing them according to their magnitude. Companies often mistakenly think they need to review transfer pricing only once every few years or that a lack of issues discovered in previous audits indicates there is no risk.

To identify and prioritize risks effectively, consider the following questions:

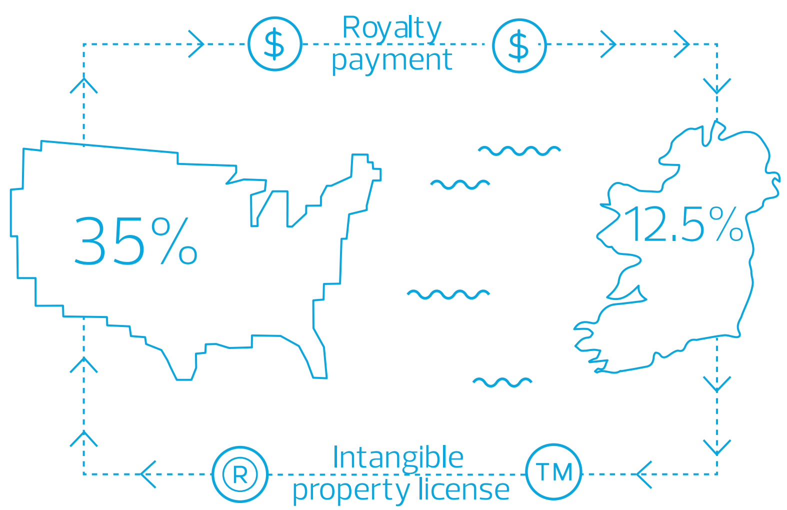
1. **Have you commenced operations in a new jurisdiction or significantly expanded operations in another?** What new transactions does this expansion create? What are the transfer pricing implications? How are the transactional data and transfer pricing decisions documented?
2. **Do your transfer pricing outcomes align with your transfer pricing policies and documentation?** Are companies' year-end results in line with what was projected at the beginning of the year? Are there adequate processes and controls in place to ensure true-up adjustments are handled appropriately? Is your intangible property being developed or used outside the jurisdiction in which the economic rights are owned? If so, are there supportable intercompany transactions recorded to account for this?
3. **Have you reviewed and reconciled your tax and accounting documents against your transfer pricing documentation?** Tax authorities will evaluate information included in certain tax forms and accounting documents for transfer pricing issues. In the United States, the IRS will look at Forms 8275, 5471/5472 and 8975, along with ASC 740 liabilities and Schedule UTP. Each jurisdiction in which you operate will have its own forms. Understanding which documents will be examined in which jurisdictions will help you identify potential risks.

BALANCING RISK AND OPPORTUNITY

Beyond just managing compliance risk, you can evaluate your jurisdictional footprint and transaction patterns for planning opportunities in order to utilize available tax attributes and minimize your global effective tax rate. Your company's risk and policy management preferences should inform these decisions.

In lower-tax jurisdictions, structuring operations to align activities, such as intangible property development or shared service centres, is a common transfer pricing planning technique. Be aware, though, of global tax reform efforts that target such strategies to ensure the economic substance behind the transactions is consistent with value creation and ensure that certain minimum levels of taxation are collected globally.

Consider this illustration. In certain circumstances, this structure could provide beneficial tax savings, but increasingly there are hurdles to achieving the desired outcome. Careful planning is required to ensure the intended tax benefits are recognized.



BUILDING YOUR TRANSFER PRICING TEAM

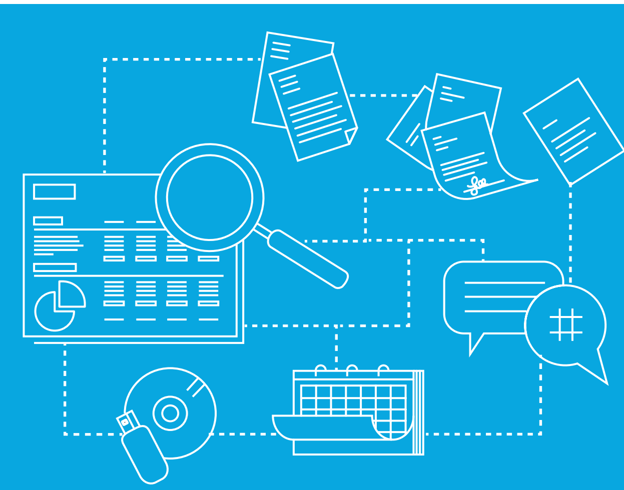
Developing and managing your transfer pricing plan is a substantial effort. Clearly defined roles are vital. Consider the following questions as you build your team:

1. Who is responsible for your transfer pricing effort, both overall and in each jurisdiction?
2. How will you co-ordinate transfer pricing activities among jurisdictions?
3. How will you establish and maintain your policies and determine when to update them?
4. Who are your key stakeholders across the business?
5. How will you communicate transfer pricing risks, planning opportunities and compliance requirements to all stakeholders?
6. Are you including all necessary perspectives on your team? For example, are your information technology people informed to ensure you capture and report data as needed?

Many middle market companies work with an outside consultant to assist with transfer pricing planning, implementation and compliance efforts. In choosing a consultant, be sure to consider the firm's experience and depth of resources, both in the United States and in jurisdictions where you operate or plan to operate.

GUIDEPOST TWO: ANALYSIS AND DOCUMENTATION

Gathering and translating your information



Gathering the information to analyze your intercompany transactions appropriately is at the heart of your transfer pricing planning effort. You may need a large volume of data from a wide variety of sources, which may be scattered across the globe in different formats, owned by various groups and collected in spreadsheets. These manual tables are time-intensive, difficult to update and offer no source data visibility. However, data and sources are just the beginning.

Through research and interviews, you will analyze that data to reach appropriate conclusions regarding the value and nature of those transactions to ensure transfer pricing compliance and drive effective decisions.

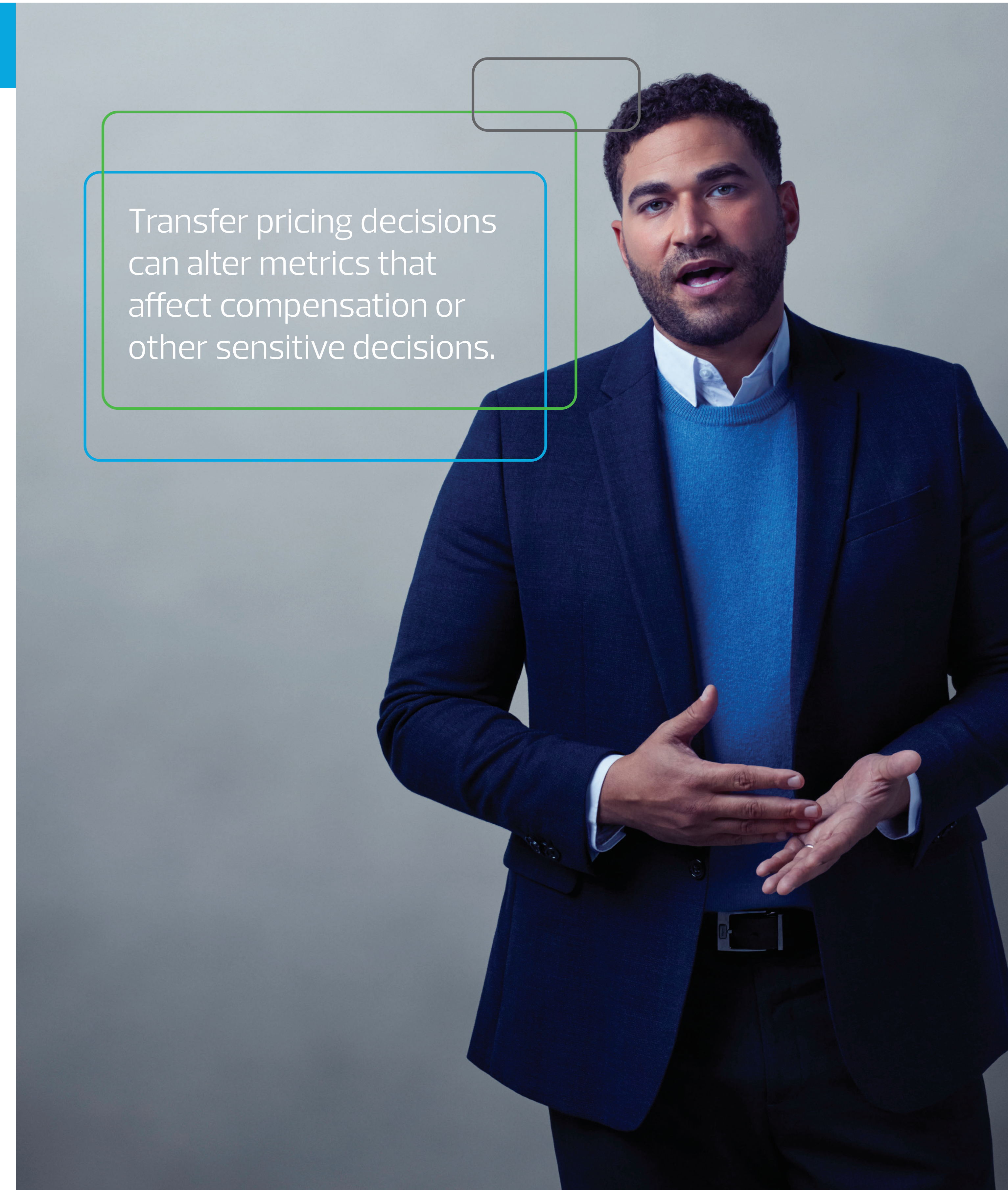
GATHERING INFORMATION

Gathering all the necessary information is one of the key challenges to an effective transfer pricing plan. Co-ordinating this effort requires open communication, clear deadlines and the right tools.

To start, decide what data you need and where that data most likely resides. Consider all your jurisdictions and consult with your transfer pricing team and consultant as you co-ordinate your information requests. Also, plan for how data will be delivered and stored.

It is helpful to establish an online repository to centralize and manage data to avoid dealing with ad hoc responses through numerous channels. The ability of systems in each jurisdiction to pull appropriate data and report it in a useful format is a key issue. It should be addressed as early in the process as possible. An integrated operational transfer pricing approach that involves efficient integration and management of data, process and controls is critical.

As with any tax compliance exercise, deadlines matter, and they should be communicated clearly and often. Finally, don't expect to receive all the information requested. Just as you have to prioritize risks, you also have to prioritize information. Be clear on what information is critical to your analysis versus what information is not as vital so you can focus your efforts on securing the most important information first.



PLANNING YOUR INTERVIEWS

Functional analysis interviews transform your raw transfer pricing data into the knowledge you need to make informed decisions about analyzing and reporting information in tax and accounting records. They will also provide valuable insights to drive future transfer pricing compliance and planning efforts.

Start by reviewing all the information received. Does it align with your understanding of the transactions, operations and other issues? Based on this initial review, you may have to reassess the scope of your project and the risks you wish to address.

Next, develop a list of persons to be interviewed. It is generally best to start with higher-level personnel so you can develop an overarching sense of operations before proceeding with a more detailed review of appropriate transactions.

When considering interview candidates, the level and position of interviewees matter, but so can longevity with the company. Long-term employees may better understand the company's practices, especially those that may diverge from written policies.

Plan for language barriers during your interviews where they may become an issue. If you are working with a transfer pricing consultant, professionals from their local offices may be able to conduct or assist with your interviews. Preparing written questions in advance can also be helpful.

WANT TO LEARN MORE?

"6 key transfer pricing considerations for multinational companies" addresses the following vital transfer pricing questions:

1. Have you appropriately assessed your level of transfer pricing risk?
2. Is your transfer pricing policy tax-efficient?
3. Do you have appropriate support for your transfer pricing policy?
4. Do you have appropriate intercompany agreements in place?
5. Are you implementing your policy in line with your transfer pricing documentation and intercompany agreements?
6. Are you considering the impact of transfer pricing on other direct and indirect taxes?

CONDUCTING YOUR INTERVIEWS

You have reviewed your data and other pertinent materials before your interviews. You have developed a clear understanding of what information you need to secure and how it relates to appropriate transfer pricing compliance. Your interviewees, in all probability, have not. It is vital, either prior to or at the beginning of the interview, to educate interviewees about the information you have and the information you desire from them, as well as the purpose of the discussion.

Understand, too, that interviewees may have different motives that shape their responses. Transfer pricing decisions can alter metrics that affect compensation or other sensitive decisions. Similarly, without an adequate explanation of the purpose of the interview, interviewees may mistakenly feel you are making judgments about business operations or their personal performance.

Also, be prepared to receive and reconcile conflicting points of view. For example, an executive at corporate headquarters may feel they provide valuable management support to subsidiaries. While a manager at one of the subsidiaries may feel they receive little or no benefit from those services.

Finally, be aware that functional interviews provide a valuable opportunity to uncover and document additional services or intangibles that are not initially identified.

ECONOMIC ANALYSIS

Once you have gathered all the information and conducted your interviews, your economic analysis provides the broader context to support your final transfer pricing decisions.

To establish the most appropriate approach to your facts and circumstances, prioritize the material transactions with the broadest operational and financial effects. You may need a variety of internal and external benchmarking data. Your industry, unique circumstances and relative jurisdictions will help determine which benchmarks should be used.

Local benchmarks, as opposed to regional, tend to drive more accurate results and may be preferred by certain taxing authorities. Co-ordinating your efforts across jurisdictions can help save resources, as some work may be leveraged across locations. This will also help to ensure a consistent approach across the enterprise.

Having an overview of historical results and policies before benchmarking will help you identify risks or opportunities at an earlier stage of the economic analysis.

The right provider can help you get the most from your economic analysis

Economic analyses are one of the most commonly outsourced transfer pricing activities.

For one thing, effective benchmarking often requires access to specialized databases. Licences to those databases are expensive, but transfer pricing providers maintain active licences and are well-versed in their use.

Different jurisdictions have different regulations regarding the data that can be used in the economic analysis, and authorities' push to limit base erosion and profit shifting drives additional changes in regulations.

A strong transfer pricing provider will have access to the right tools and will be fully versed on the latest regulatory changes.

DOCUMENTATION

Once your economic analyses are complete, refer to your transfer pricing plan to determine how the results should be incorporated into documentation that fulfils all the requirements of the respective local jurisdictions. Although most jurisdictions generally adhere to the documentation standards promulgated by the OECD, each country may have local nuances that should be carefully considered and addressed.

In selecting your transfer pricing provider, it is important to be clear about whether you are looking for a general OECD-based approach to documentation or seeking full compliance in some or all local jurisdictions. For the latter, it is critical to work with an advisor who has a presence in those countries.

GUIDEPOST THREE: IMPLEMENTATION, TECHNOLOGY AND OPERATIONAL TRANSFER PRICING

Sustaining benefits through systems and integrated processes

A company pays for a transfer pricing study to provide the economic analysis necessary to support its transfer pricing decisions if the conclusions are challenged by the IRS or tax authorities in another jurisdiction. But these studies don't come with instructions for implementation.

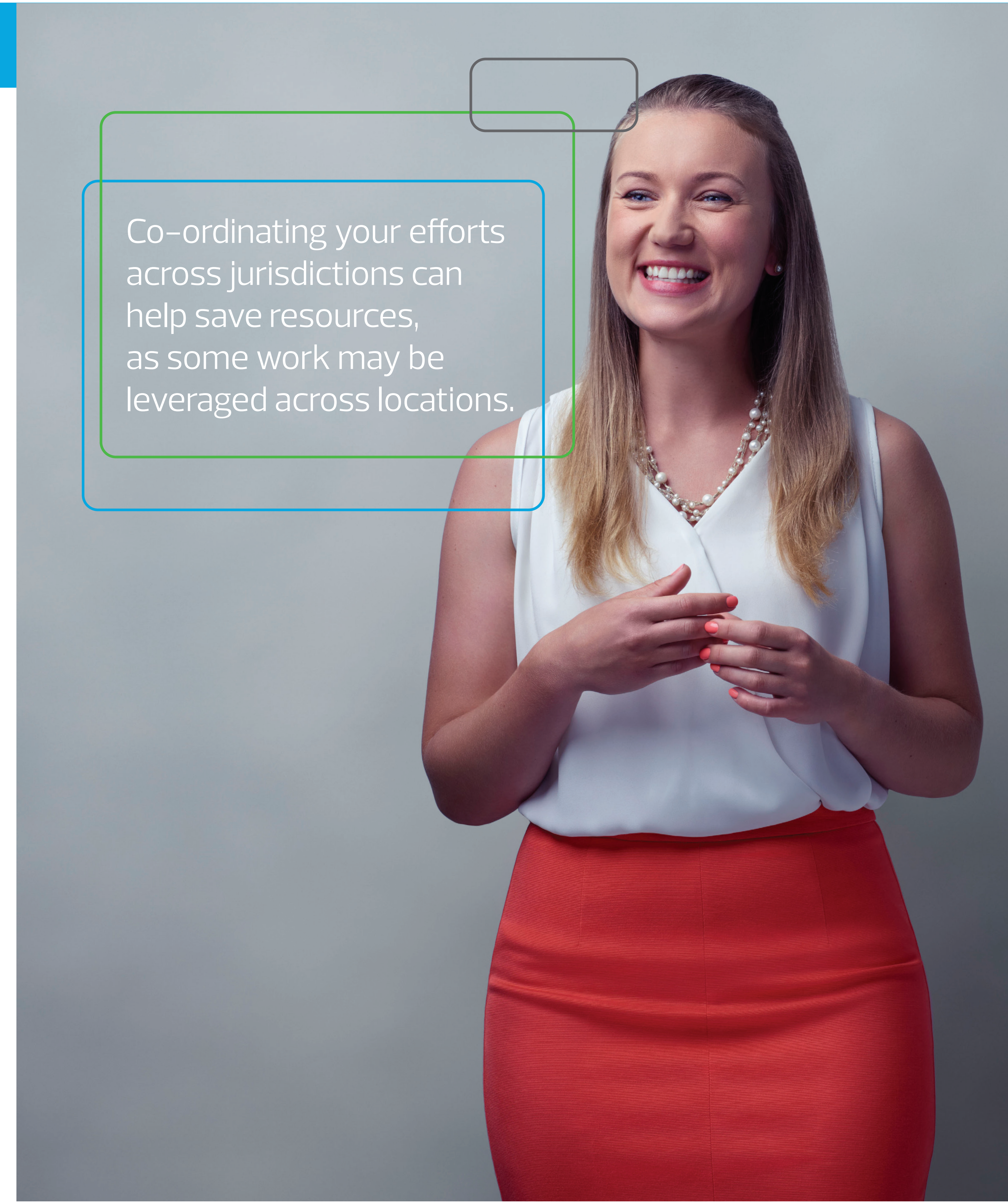
As a result, companies sometimes just put the study on a shelf, thinking that the study alone is enough. Then, when a taxing authority challenges the company's transfer pricing decisions, the company finds it has not aligned its policies and systems to reflect its own transfer pricing study. In fact, the study provides evidence against the company.

Once a company has a thorough transfer pricing study, the benefits stem from effectively implementing policies and procedures that translate the findings into the company's operational and financial statements. Proper implementation is increasingly important as the IRS and tax authorities around the world crack down on companies that make unsupportable transfer pricing decisions to shift profits and avoid taxes.

Keep in mind that transfer pricing is often a double-edged sword. Different taxing authorities in the same jurisdiction can have conflicting positions; for example, changes to inventory pricing could increase income tax liabilities but decrease customs liabilities, or vice versa. Decisions that satisfy the authorities in one jurisdiction may cause those in another to look closer.

WANT TO LEARN MORE?

Find out how operational transfer pricing can benefit your organization's implementation process.



STAKEHOLDER SATISFACTION

While you may be part of one enterprise, you are also likely to have a collection of stakeholders with varying agendas. Identifying your stakeholders and understanding how your transfer pricing conclusions will affect them should enable you to collaborate on implementing changes to policies and processes.

Understand that transfer pricing implementation does not just involve the tax function. Effective implementation will require considerable co-ordination among operations, finance and tax. Consider collaborating on these two steps:

1. Determine which transactions have the greatest impact on your overall transfer pricing position.
2. Define exactly what will be needed from each function and assign responsibilities accordingly, focusing on risk to help drive these efforts.

WITHSTANDING SCRUTINY

Of course, those inside your organization are not your only priority. With jurisdictions around the globe more aggressively targeting transfer pricing practices, ensure that everything from your plan to your implementation is ready to withstand scrutiny.

As tax authorities sharpen their focus on data integrity and transfer pricing governance, they expect taxpayers to show they have adequate processes and controls in place to ensure transfer pricing outcomes at the legal entity level match expectations. To that end, companies need to have a consistent narrative for compliance purposes that covers policies and data.

Organizations are being assessed on whether their transfer pricing policies match what's happening on the ground. Tax authorities are also looking at whether companies' year-end results align with what they projected when the year began and, if not, whether they have a good business reason for any true-up adjustments.

You also must be sure to collect documentary support for transfer pricing decisions, such as intercompany agreements and communications, minutes, policy memos and invoices. All material intercompany transactions should be reconciled against this documentation.

Then, consolidate all this activity into a comprehensive transfer pricing manual for the controllership function. This manual provides the road map for reflecting the entire transfer pricing process in the general ledger.

Want to learn more?

Check out these industry-focused podcasts:

- Transfer pricing planning opportunities for life sciences companies
- Transfer pricing planning opportunities for manufacturing companies
- Transfer pricing opportunities for consumer businesses

You should know:

Tax authorities may go the extra mile to determine whether your company's transfer pricing policies match actual business practices. They may carry out their own interviews, for example. It is not unprecedented for them to search the internet and scrutinize a company's website. If the transfer pricing study indicates the company does not have valuable intangibles, but marketing on the internet extols the benefits of proprietary technology, this could lead to questions.

SYSTEMS

Historically, multinational organizations upgraded their finance systems by investing in enterprise resource planning (ERP) systems. But those efforts generally focused on managing the business instead of specific legal entities. Alignment of the commercial, finance and tax functions was often not considered. Hence, ERP systems proved to be ineffective for managing the tax and transfer pricing processes.

As focus intensifies on data and digitalization, organizations realize the importance of properly scoping and budgeting for tax during the initial phases of an ERP implementation. ERP design decisions have direct tax, indirect tax (e.g., sales and use tax, value-added tax, goods and services tax), and international tax implications that are not immediately apparent or understood by nontax resources. Some key operational transfer pricing challenges and root causes are buried in the ERP core, for example:

- Disintegrated data feeds from multiple data sources
- Upstream systems and data models with missing relevant counterparty information
- Undefined and complex entity product structures and hierarchies
- Missing requisite flags and data fields in ERP master data
- Invoice details and amounts provide insufficient operational transfer pricing information required for compliance or alignment with policies and jurisdictional requirements

Your company can save time and money by involving tax and transfer pricing as early in the implementation process as possible while providing an opportunity for your tax department to enhance its tax technology ecosystem and focus on tasks that add value, such as tax and transfer pricing planning.

PERPETUATING THE LIFE CYCLE

Going forward, how will you monitor your transfer pricing effort to ensure your conclusions are implemented appropriately across your organization? This question highlights the importance of your transfer pricing team—having the right resources in place across your enterprise to ensure ongoing compliance can make a tremendous difference.

Finally, don't view the transfer pricing exercise as a one-time effort or something you can put on a shelf for a few years. Having done the work to identify your key risks and the transactions that drive them, review your transfer pricing plan annually, at a minimum, to keep your guideposts aligned with your evolving global business. Navigating by those guideposts will help you identify effective tax planning opportunities within your enterprise:

WANT TO LEARN MORE?

RSM's transfer pricing services can help you reduce your risks and increase your efficiencies.

+1 855 420 8473
rsmcanada.com

eb-mr-itax-all-0622