A series of articles based on our Global Transfer Pricing Conference in Shanghai, China – October 2015

Transfer Pricing Perspectives: Beyond boundaries

pwc

www.pwc.com/tpperspectives

Foreword

Isabel Verlinden
Global Leader, Transfer Pricing
PwC Belgium

+32 2 710 4422
isabel.verlinden@be.pwc.com

According to good traditions, we brought again over 200 PwC specialists and close to 400 clients together for our annual Global Transfer Pricing Conference. This year, we were hosted by our PwC Shanghai experts. The popularity of this event is the best proof that navigating operations in an ever-expanding globalised world is creating significant challenges from an international tax and transfer pricing perspective. Indeed, the stringent, diverse transfer pricing requirements companies face are daunting. As they align their business supply chains, tax, and legal operating models to deliver sustainable financial benefits, the pressure is on to achieve these goals within a strict and divergent transfer pricing environment.

The articles in this October 2015 edition of Transfer Pricing Perspectives are based on a number of sessions from our conference in Shanghai, and are designed to help you getting equipped for the changes we're sure to see in the coming months.

There have continued to be significant changes in the area of transfer pricing, with several new countries implementing either formal or informal transfer pricing documentation requirements and significant regulatory changes in many other countries over the past 12 months. Most significantly, the deliverables released as part of the OECD's Base Erosion & Profit Shifting (BEPS) Action Plan have resulted in the need for companies to re-evaluate and reconsider their transfer pricing strategies in light of the proposed new guidance.

Undoubtedly, the tax world will also continue to see a lot of change in the next year – and for years after that. And as transfer pricing tops more and more media headlines – and internationally coordinated efforts to aggressively collect taxes escalate even further – the number of interested stakeholders is expanding. This evolving landscape presents an even greater challenge to company executives who need to keep their finger on the pulse of change and constantly adapt their transfer pricing strategies.

Foreword

We anticipate that this will be another eventful year. Companies will need to disclose more information on their intercompany price setting than ever before. The public debates on the ethics of tax planning increases the pressure even more and some see the new world as one where disclosure becomes a corporate reporting standard. At PwC we welcome the ongoing efforts to update the international tax system and boost transparency. This being said, there is a need for a serene debate as transfer pricing and "mispricing" are different things. Tax officers in the respective countries in which a group operates may react differently to what is ultimately disclosed. Well trained tax examiners will be a prerequisite to mitigate the risk of a further surge in the number of transfer pricing disputes globally.

I am confident you will enjoy the reading of this Perspectives as the enthusiasm of the many authors glimmers through. Enjoy the reading and please get in touch with your PwC contact as we are keen to engage further in a dialogue on this challenging topic.

Isabel Verlinden

*PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

Contents

Beginning with the end in mind: Audit ready preparedness in an evolving compliance environment

Beginning with the end in mind: Audit ready preparedness in an evolving compliance environment

In the Asian region in particular, the growing scrutiny and increasing sophistication of revenue authorities has seen unparalleled growth in audit activity. For example, revenue authority collections have grown five-fold in China in the last five years.

Introduction

The intensity of transfer pricing disputes continues to escalate on the back of rapidly evolving transfer pricing reform, public scrutiny of multinational enterprises (MNEs), and access to greater resources by revenue authorities globally to enforce what has become an increasingly political issue.

This article discusses recommended best practice for the early prevention of disputes, together with perspectives on effective audit management in selected countries in Asia.

The transfer pricing audit landscape globally

Effective transfer pricing audit management is now more relevant than ever in view of increasingly co-ordinated multilateral approaches to transfer pricing compliance and audit management globally. This is demonstrated through the G20 and Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) projects. This includes greater collaboration and transparency initiatives (i.e. country by country reporting) for information sharing amongst revenue authorities, which is likely to prompt further increases in audit activity as revenue authorities continue to target their fair share of MNE profits.

In the Asian region in particular, the growing scrutiny and increasing sophistication of revenue authorities has seen unparalleled growth in audit activity. For example, revenue authority collections have grown five-fold in China in the last five years.

Beginning with the end in mind: Audit ready preparedness in an evolving compliance environment

Key audit risk areas

Arrangements that are likely to attract greater revenue authority scrutiny in the current environment include:

- Business restructures (particularly where valuable intangibles have been migrated),
- Intra-group financing arrangements,
- Loss making entities,
- Companies with significant related party dealings,
- Companies with a low effective global tax rate,
- Dealings with tax haven jurisdictions,
- Complex tax structures, and
- Services in low cost jurisdictions i.e., where location savings are arguably derived.

Best practices for prevention of disputes up-front

The starting point for a robust transfer pricing defence position commences with sound analyses, policies and procedures.

However, preparation of transfer pricing analysis, documentation and policies for higher risk transactions should be inherently different from an analysis of a transaction that is likely to carry a lower risk profile in the eyes of a revenue authority.

In a rapidly changing world, with mobile workforces and fast changing technology, retracing steps years after a transaction occurs to identify relevant information can prove very difficult, and sometimes even impossible. Hindsight has shown that while the contemporaneous preparation of a robust 'audit ready' analysis may require more focussed effort up front, it results in substantial time and cost savings in the long run.

Practically, if one thinks about a robust transfer pricing analysis as consisting of a functional/ factual analysis, selection of the most appropriate transfer pricing method, application of that transfer pricing method (i.e. economic analysis), and ongoing implementation and monitoring of the arrangement, the following best practice tips and tricks can operate to reduce the likelihood of a revenue authority adjustment.

1. Functional/factual analysis

Almost all transfer pricing disputes hinge on a misunderstanding or disagreement between the parties around the facts relevant to establishing the arm's length price. That is, the facts that are critical to determining the key functions performed, assets utilised, and risks borne by the MNE, and in turn the key value drivers of the business.

Beginning with the end in mind: Audit ready preparedness in an evolving compliance environment

With higher risk transactions, to establish a robust audit ready defence file a taxpayer needs to do more than simply "tell a story". Whilst the story may be factually accurate, proving the story in the event of a dispute requires a more extensive exercise focussed on establishing the appropriate granularity of facts through the contemporaneous preparation of documentary evidence, including:

i. **Written statements**

Where possible, written statements should be obtained from influential senior executives (e.g. heads of department, CFO and CEO) documenting the MNE's business strategy and value drivers.

Involving senior business officials contemporaneously and at the time of a revenue authority dispute can lend additional weight, particularly where it can be shown that the intercompany arrangement is driven by commercial rather than tax objectives.

Board documents and approvals together with public company statements can be an excellent source of contemporaneous documentary evidence in this regard.

ii. **Legal agreements**

Both related and unrelated third party agreements relevant to an intercompany arrangement should be prepared and maintained on file.

Beginning with the end in mind: Audit ready preparedness in an evolving compliance environment

It is also important to evidence that the transaction has been implemented in accordance with the legal agreement (e.g. through invoices, written correspondence between the parties, and accounting entries).

Establishing the key terms of a transaction and intent of the related parties becomes increasingly difficult in the absence of a written agreement and leaves a taxpayer exposed to a greater risk of revenue authority disagreement as to the legal and economic effect of a transaction.

iii. Financial analysis

Financial analysis should be considered to quantitatively support claims made by business representatives where possible e.g. quantifying business improvements of a transformation initiative, or evidence relevant to the quantitative significance of a risk borne by a party such as insurance, warranty and credit claims etc.

iv. Third party analyst reports

Third party analyst reports of a company or industry can provide an independent and objective perspective.

v. Decision making processes

Given an increasing focus on people functions, particularly in the context of managing risk, contemporaneously preparing documentation evidencing the decision making process for key functions and risk processes can be particularly helpful. This might include process maps, curriculum vitae's, parameters of authority, and email correspondence. As a general comment, it is often valuable to play 'devil's advocate' throughout the functional analysis and fact finding stage from the perspective of a revenue authority. In this regard, it is helpful to cross-check statements made by personnel with evidence gathered from varying sources.

Third party analyst reports of a company or industry can provide an independent and objective perspective.

Beginning with the end in mind: Audit ready preparedness in an evolving compliance environment

2. Selection of the appropriate transfer pricing method

There is often potential for revenue authority disagreement regarding the selection of the most appropriate transfer pricing methodology where the method is not codified or prescribed.

It may be useful to consider:

- The use of more than one method as a cross-check;
- Potential internal comparables. These should not be disregarded too quickly, and examined closely and adjusted for comparability where possible.
- Although a transaction might not be sufficiently comparable, it may provide a 'line in the sand' for the arm's length transfer price e.g. a cap or floor;
- Again, playing devil's advocate can be helpful. Consider mounting an argument for the use of a different methodology to identify flaws in your methodology.

3. Application of the transfer pricing method

When applying the selected transfer pricing method, it can be helpful to take into account the following:

- Contemplate the validity of all publicly available sources for comparable information (e.g. annual reports),
- Evaluate and document the comparability factors in detail,
- Perform sensitivity and scenario analysis to sense check the risk of a revenue authority disagreeing with a particular economic variable.

4. Implementation and review

The above described analysis should be performed periodically to account for any changes in the business and economic environment.

It is particularly important to ensure as part of the implementation and review process that the MNE adopts the transaction as originally intended and contractually agreed.

Any variations or amendments to the arrangement should be documented contemporaneously.

Any changes should be communicated to the transfer pricing function as soon as possible.

Beginning with the end in mind: Audit ready preparedness in an evolving compliance environment

Best practices during reviews and audits

It is important to develop and decide on a strategy for communicating and dealing with the revenue authority(ies) and internal business stakeholders early on in the process.

Some useful considerations to managing a revenue authority enquiry, which will be highly dependent on the nature of the dispute and operating jurisdiction, include:

Engage in dialogue with the revenue authority early to:

- understand the basis for their position/their key concerns,
- identify key areas of disagreement,
- resolve any misunderstanding of the facts;

Understand the relevance of the line of questioning and keep the enquiry on track;

- Understand your rights and responsibilities e.g. when responding to information requests;
- Ensure responses are robust and technically and factually correct and, where possible, supported with evidence;
- Consider the use of an internal steering committee and establishing governance around communicating audit developments internally.

Resolving transfer pricing controversies

A majority of transfer pricing disputes are ultimately settled as part of commercial negotiations on a principled basis.

Where settlement discussions are not fruitful, alternative dispute resolution approaches can be helpful in achieving an outcome satisfactory to both parties, including mediation or arbitration.

The use of independent experts or arbitrators can be helpful in this regard e.g. industry or economic experts.

In some jurisdictions advance pricing arrangements (APAs) and mutual agreement procedures (MAP) can provide an alternative means of pre-emptively preventing or resolving a dispute. MAP can provide a balanced perspective with input from a counterparty jurisdiction that can give rise to satisfactory outcomes on a multilateral basis.

Beginning with the end in mind: Audit ready preparedness in an evolving compliance environment

Perspectives on audit environment and effective audit management in selected countries in Asia

China

The China State Administration of Taxation (SAT) has significantly increased its focus on transfer pricing in recent years. Key areas of focus for the SAT include:

- intra-group services and intangibles transactions,
- emphasising the importance of location specific advantages,
- requiring more extensive information to provide a holistic view of the group value chain and contribution of value chain participants, and
- enhancing the verification of the authenticity and accuracy of a taxpayers' related party disclosures with its financial accounts.

The SAT has strengthened its anti-tax avoidance monitoring system with emphasis on reviews of transfer pricing documentation and related-party transaction disclosures, single entity or group-wide multi-entity joint audits, follow-up administration after transfer pricing investigations, and management of self-adjustment by taxpayers.

Transfer pricing audits in China almost always end with a negotiated settlement, as administrative appeals are not effective and litigations are rare. Robust analysis and effective communication are keys to successful audit management. MAP is frequently initiated as a remedy to avoid double taxation and APAs are commonly used to prevent disputes.

Recent trends indicate that taxpayers small and large are increasingly facing pressures to perform self-adjustments as an alternative to be under a formal investigation. However, resolving the dispute via a self-adjustment vis-à-vis a formal investigation should be considered having regards to the relative merits of either approach based on the particular case.

The China State Administration of Taxation (SAT) has significantly increased its focus on transfer pricing in recent years.

Beginning with the end in mind: Audit ready preparedness in an evolving compliance environment

Japan

Transfer pricing audits can be conducted either as a part of a corporate tax audit or as a separate transfer pricing examination by the National Tax Agency (NTA).

During the audit, the tax authorities will conduct various interviews, look into detailed financial data, and request overseas information including segmented profit & loss data for cross-border transactions.

Presenting thorough transfer pricing documentation at the beginning of the audit is the key to preventing the tax authorities from conducting a prolonged transfer pricing audit.

APAs are very common in Japan and an effective means of cooperative compliance and dispute prevention. Over one hundred APA applications (a majority of them bilateral) are filed every year.

During the audit, the tax authorities will conduct various interviews, look into detailed financial data, and request overseas information including segmented profit & loss data for cross-border transactions.

Beginning with the end in mind: Audit ready preparedness in an evolving compliance environment

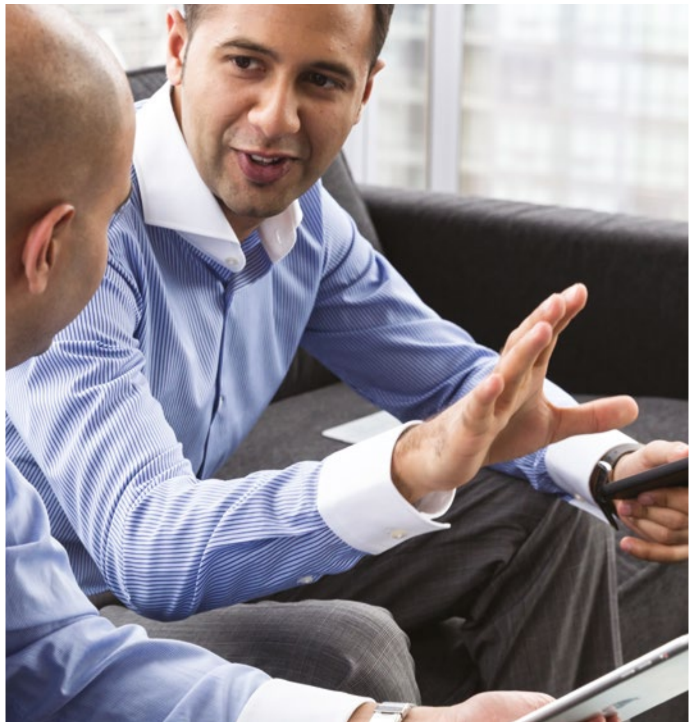
India

The Indian Revenue Service (IRS) is yet to establish risk based compliance processes and as a result audits all cross-border dealings in excess of INR 150 million (US$ 2.5 million).

The following IRS trends and practices have been observed:

- Exchange of information between Income Tax and Customs Department;
- Use of social networking information (e.g. Linkedin profiles) to audit functional characterisation;
- Exercise of power to record statements on oath, inspect office premises, obtain information from third parties, etc.;
- Exercise of power to apply the transfer pricing provisions in respect of transactions with non associated enterprises in certain notified non-cooperative jurisdictions which lack effective exchange of information.

Disputes can be resolved via a Dispute Resolution Panel (DRP), which is a unique mechanism to pre-empt disputes. Further, APAs are commonly used by taxpayers to prevent disputes.



Key takeaways

MNEs should be aware of key audit areas across their operating jurisdictions and pre-emptively develop robust transfer pricing policies and procedures.

Specifically, taxpayer's should begin with the end in mind by anticipating revenue authority challenges, and developing robust documentary evidence to establish the fact profile and economics required to robustly defence its cross-border dealings.

Such analysis may prove more onerous initially, but will save significant time and resources in the long run.

Taxpayer's should begin with the end in mind by anticipating revenue authority challenges.

Authors

Qisheng Yu
PwC China
+86 10 6533 3117
qisheng.yu@cn.pwc.com

Dritton Xhemajlaj
PwC Australia
+617 3257 5646
dritton.xhemajlaj@au.pwc.com

Beyond spreadsheets: Emerging trends in transfer pricing technology

Beyond spreadsheets: Emerging trends in transfer pricing technology

Often, a handful of key individuals, none of whose job descriptions include a full-time concentration on transfer pricing, spend thousands of processing hours gathering data, calculating results, and booking and documenting intercompany transactions. There's a better way.

Background

Intercompany execution always has been a complex undertaking. The growth of international trade and the increasingly complex operating structures of multinational enterprises (MNEs) are straining legacy systems and already limited personnel resources.

Typically, organisations internally measure operational performance using pre-tax management accounting. In this context, intercompany transactions, allocating income and expense between related parties impacting legal entity accounts, may largely be an afterthought for all except corporate tax and legal leadership.

As a result, enterprise resource planning (ERP) systems may not be optimised for intercompany and transfer pricing execution, making day-to-day transactions heavily dependent on manual intervention, so-called 'human middleware.' Often, a handful of key individuals, none of whose job descriptions include a full-time concentration on transfer pricing, spend thousands of processing hours gathering data, calculating results, and booking and documenting intercompany transactions.

Compounding existing challenges, the new reporting environment under the Organisation for Economic Co-operation and

Beyond spreadsheets: Emerging trends in transfer pricing technology

Development's (OECD) Action Plan on Base Erosion and Profit Shifting (BEPS) is focused on granular visibility with respect to the impact of transfer pricing flows on a corporation's effective tax rate and the financial results of specific entities. As a result, MNEs need to provide timely and accurate financial data management coupled with real-time reporting and reconciliation capabilities.

To meet these additional data and transparency challenges, companies increasingly are looking to the capabilities of their information technology (IT) systems to make the process of collecting, calculating, analysing, and reporting transfer pricing data more efficient and productive. Although historically considered the domain of finance, controllership, and IT functions, corporate tax practitioners are best advised to embrace proactively the potential for technology to improve transfer pricing effectiveness and support increased global documentation and reporting requirements.

Manual intervention in transfer pricing execution

Frequently, intercompany execution is managed through an array of unwieldy spreadsheets by a handful of key individuals. These spreadsheets may be used to determine intercompany charges for a range of transactions, including overhead and headquarters services, cost-sharing allocations, financing, and intellectual property licensing. For tangible goods businesses, intercompany price setting may be handled through spreadsheets.

These spreadsheet models generally are designed ad hoc often reflecting the quirks of their creators. Over time, they can degrade as a result of internal structuring changes, such as the addition of new cost centres and legal entities, and external factors, such as changing local tax rules. Due to the lack of governance around them, spreadsheets also are prone to hardcoded, one-off adjustments, often left undocumented resulting in potential confusion and risk when the results must be explained and defended. Much is at stake, as usually the gross intercompany transaction values are significant.

To meet these additional data and transparency challenges, companies increasingly are looking to the capabilities of their information technology (IT) systems to make the process of collecting, calculating, analysing, and reporting transfer pricing data more efficient and productive.

Beyond spreadsheets: Emerging trends in transfer pricing technology

MNEs tend to rely on spreadsheets for a variety of reasons. For instance, when there are multiple legacy financial systems, often the result of previous acquisitions that were not integrated or organic growth outpacing the expansion of the systems function, building an integrated intercompany solution is challenging. Also, personnel performance metrics often are based on management reporting, rather than legal entity financial results, reducing the motivation to address transfer pricing execution at the enterprise level. Similarly, the organisation may take the view that transfer pricing is solely an issue for the tax return and requires only an annual offline calculation.

MNEs that employ robust ERP systems still may find it difficult to incorporate transfer pricing into their financial reporting processes and procedures. For example, a company may have a single global 'instance' of an ERP, defined as a discrete implementation, with a common chart of accounts, functional areas, business units, and geographies. However, unless tax and transfer pricing issues were explicitly considered during the design and implementation of ERP, the company may find it too expensive to retrofit transfer pricing logic, relying instead on the corporate tax department to bridge the gap with spreadsheets.

Bringing technology to bear

Recent advances in transfer pricing technology solutions offer a range of options for companies – from tactical to broad spectrum.

Tactical technology solutions

Tactical transfer pricing technology aims to address these issues through targeted automation, typically using a middleware database application that is more rigorous and sophisticated than a collection of spreadsheets, but may be less costly than business intelligence software or ERP modification projects. Tactical technology solutions tend to address specific calculation and reporting issues, such as management fee allocation, profit-in-inventory elimination, and legal entity profit monitoring.

MNEs that employ robust ERP systems still may find it difficult to incorporate transfer pricing into their financial reporting processes and procedures.

Beyond spreadsheets: Emerging trends in transfer pricing technology

Generally, these tactical solutions are built as custom applications on common database platforms, starting with a flat-file data extract from financial or data warehouse systems. Able to handle large data volumes, providing traceable data mapping, including replicable business logic, and storing results for multiple periods, these bespoke database solutions often can be implemented in under six months. They are owned and maintained by the tax function, without requiring a heavy touch from the IT department or finance.

By implementing a more automated system for administering routine intercompany charges, MNEs can increase operational efficiencies, improve data quality and data availability, meet tax and financial reporting requirements in a more timely and efficient manner, mitigate risks, increase the transparency of the charge out process, and reduce audit risks and improve audit defence support.

Workflow and collaboration

Despite the speed of change within most MNEs, many organisations' systems do not keep pace with the evolving needs of the tax function to compile information, analyse data, provide progress outputs, and produce tailored reporting to comply with complex regulatory requirements and deliver insight to the business. Instead, corporate tax personnel today may have to spend a considerable portion of their time on data collection, rather than on true tax analytic and risk management activities.

Workflow and collaboration platforms can drive process improvement and transparency and significantly transform a tax department's productivity. By leveraging these tools to automate the organisation of transfer pricing information and processes, companies can realise more efficient use of staff and improved internal controls, greater efficacy in meeting quarter and annual close requirements, and improved audit defence readiness and audit trail.

Typically web-based, these platforms generally encompass enterprise content and data management providing the ability to store, track, and manage electronic documents and assets as well as social networking, task scheduling, and collaboration elements. The user interface for these types of technology solutions is highly customisable and can be configured to match the corporate Intranet site, or other company-wide internal portal, and can be linked to existing systems.

Workflow and collaboration platforms can drive process improvement and transparency and significantly transform a tax department's productivity.

Beyond spreadsheets: Emerging trends in transfer pricing technology

Embedded system solutions

The ideal approach to transfer pricing execution is holistic – considering the end-to-end process and drawing together the wider value chain into a well-defined set of procedures, from strategy to financial and operational systems, financial reporting, and tax compliance.

MNEs rely on their internal systems to accurately price, record, and report transfers of tangible goods, licenses or sales of intellectual property, and the provision of services and financing between related parties.

As a threshold matter, designing an ERP system that strategically enables efficient end-to-end transfer pricing execution requires an understanding of intercompany functions and processes
For example, the logic must be in place to set legal entity profit levels during the budgeting process, calculate target transfer prices or mark-ups, allocate intragroup services charges, monitor interim results, prepare adjustment entries, forecast pricing changes, simulate alternative scenarios, and maintain supporting documentation and audit defence files. Each of these tasks requires detailed analysis. Adding significant complexity is the fact that these activities must take place with reference to legal entity results and factor in local Generally Accepted Accounting Principles and timing adjustments.

For instance, if an intercompany transfer price must be updated for a specific product line or stock-keeping unit (SKU) based on a review of the latest quarterly financial results, the required analysis would entail determining the cost and selling price of a given product at a global level as well as the entity level to ensure that both the local and global margins of the product remain within policy guidelines. Given that transfer pricing policy targets often are set using a bottom-line measure of profitability (e.g., operating margin), indirect and overhead costs must be apportioned at the product or even SKU level. Taking into account the additional mandate to forecast transfer pricing results, rather than just to monitor actual results, effectual transfer pricing execution depends on an analytical technology framework rather than a purely transactional system.

An emerging technology for approaching the broader end-to-end process is enterprise performance management

Beyond spreadsheets: Emerging trends in transfer pricing technology

(EPM), also known as corporate performance management (CPM). EPM is not a new concept in the world of financial systems; however, its application to transfer pricing is a recent phenomenon.

Primarily, EPM is concerned with transforming organisational planning across strategy formulation, business planning and forecasting, financial management, and supply chain effectiveness. Many MNEs employ EPM to conduct profitability modelling and optimization across their value chains. Because EPM can identify and apportion granular cost data, it helps companies effectively segment profitability across business lines, products, services, and customers and allows for modelling the profit impact of strategic changes among resources and cost.

The read across to transfer pricing seems compelling. By designing, implementing, and integrating EPM within existing financial systems, MNEs can take a holistic approach to automating intercompany transactions, setting and calculating intercompany prices at a cost-plus or resale-minus level. At the same time, they can review profitability to segment results by legal entity, or by product or service within a legal entity, in order to test accordance to transfer pricing policy. New avenues for planning also are created whereby MNEs can model the impact of changes to resources, cost, or other factors on their intercompany pricing strategies.

Although EPM solutions may offer significant promise, implementation is not possible unless the MNE first undertakes a thorough, enterprise-level review of its end-to-end transfer pricing processes and systems landscape.

As part of building consensus among key stakeholders and senior management for this kind of large-scale technology transformation, corporate tax leadership also must ensure cross-functional collaboration with management information systems, information technology, human resources, and accounting and financial reporting leaders to assess user requirements and drive budget priorities.

Beyond spreadsheets: Emerging trends in transfer pricing technology

The road ahead

With the OECD's BEPS Action Plan calling for greater transparency and compliance requirements worldwide, the need for accurate and timely calculation, analysis, and reporting of operational and financial data has never been more critical. MNEs rely on their internal systems to accurately price, record, and report transfers of tangible goods, licenses or sales of intellectual property, and the provision of services and financing between related parties. Not maximising transfer pricing execution can translate to increased risk and a possible impact to the bottom line.

Recent technological innovations, both tactical and holistic, have emerged to support corporate tax leaders in complying with the new protocols established by the jurisdictions in which they operate as a result of the OECD's BEPS project.

To leverage these emerging technologies, corporate tax executives need to work cross-functionally bridging operational, financial, and information management systems to assess their tax and transfer pricing user requirements and develop end-to-end solutions to intercompany transaction execution.

The ideal approach to transfer pricing execution is holistic – considering the end-to-endprocess and drawing together the wider value chain into a well-defined set of procedures, from strategy to financial and operational systems, financial reporting, and tax compliance.

A version of this article appeared in Tax Notes Int'l, September 21, 2015, p. 1033.

Beyond spreadsheets: Emerging trends in transfer pricing technology

Authors

David Nickson
PwC US
+1 646 471 6814
david.a.nickson@us.pwc.com

Andrew Hwang
PwC US
+1 646 471 5250
andrew.hwang@us.pwc.com

Liz Sweigart
PwC US
+1 713 356 4344
elizabeth.a.sweigart@us.pwc.com

Simon Wood
PwC UK
+44 207 212 3861
simon.wood@uk.pwc.com

Demystifying transfer pricing execution and intercompany accounting

Demystifying transfer pricing execution and intercompany accounting

For large multinational companies that must comply with myriad tax policies and regulatory agencies all over the world, transfer pricing has always been a complex undertaking. With more organisations expanding into international markets, and with new regulations shining a spotlight on the source of profits and where those profits are being reported, transfer pricing has never been more important than it is today.

A case in point is the recent commitment by 44 countries, made at the G20 Summit in Cairns, Australia, in September 2014, to accept the Organisation for Economic Co-operation and Development (OECD) country by country reporting template by the end of 2016. This commitment – to disclose to local tax jurisdictions (once they adopt matters into local law) where profits are made and how they are allocated across jurisdictions, was a big step for organisations that are multinational.

A case in point is the recent commitment by 44 countries, made at the G20 Summit in Cairns, Australia, in September 2014, to accept the Organisation for Economic Co-operation and Development (OECD) country by country reporting template by the end of 2016.

As companies frequently do not have pricing aligned for how they record and report transfers of tangible goods, licenses, sales of intellectual property or the provision of services and financing between related parties, country by country reporting will bring greater transparency to how multinational value chains are distributed globally.

The leading practice is for corporate executives to work cross-functionally, bridging

operational, financial, and information management systems, aligning transfer pricing with the pricing and execution approach within their Enterprise resource planning (ERP) and reporting systems. However, in a February 2014 survey conducted by PwC

Demystifying transfer pricing execution and intercompany accounting

that asked senior tax executives about the technology gaps with tax functions, the majority of the respondents felt that intercompany transfer pricing execution and compliance have been neglected in their ERP and business intelligence designs. Our experience with clients confirms that thousands of hours and millions of dollars are frequently spent on highly manual processes, fraught with risk, to work around this identified gap.

Having an IT infrastructure that supports complete transfer pricing transparency, is of paramount importance for any multinational. System design must support a full integration of ERP transactions with tax reporting. A challenge for many organisations that run SAP software, however, is that their initial system designs did not factor in this granular level of transactional oversight or the processes to support a global transfer pricing solution. Just as segmented financial reporting created challenges for aging systems, so too does increased transfer pricing scrutiny.

Strategy starts with design

From a strategy standpoint, the key question for transfer pricing execution is this: How does an organisation ensure that the right information is being captured at the transaction level? Greater transparency is required not only to drive compliance, but also to enable a pricing forecasting model so that an organisation can defend its pricing adjustments in the event of an audit. An analytics tool is also required to analyse and monitor changes in price adjustments necessary to conform with the company's transfer pricing policies.

The reason initial system designs did not factor in the level of transactional oversight required to satisfy transfer pricing considerations is that ERP systems traditionally have been designed to support only the core business operations, and not tax or legal reporting requirements. Current leading practices call for tax and transfer pricing requirements to be incorporated in the blueprint of the ERP design, with IT professionals working closely with tax colleagues to achieve appropriate integration. Many companies have rejected this approach because the upfront setup costs can be high. However, when compared to the cost of remediating these differences on an annual basis, the initial expense is often significantly less in the long term.

Greater transparency is required not only to drive compliance, but also to enable a pricing forecasting model so that an organisation can defend its pricing adjustments in the event of an audit.

Demystifying transfer pricing execution and intercompany accounting

Designing an ERP system to support transfer pricing requires an understanding of transfer pricing functions and processes.

Moreover, ERP system upgrades do not always keep pace with growing geographic footprints or operational expansion, particularly in newer companies. Often the cost-conscious and entrepreneurial mindset of an emerging multinational enterprise translates into systems that lag behind the needs of the business over time. As a result, companies often have to deal with disparate transactional systems, redundant and decentralised data, and massive data volumes.

Designing an ERP system to support transfer pricing requires an understanding of transfer pricing functions and processes. Tasks include setting legal entity profit levels during budgeting, calculating target transfer prices or markups, allocating intercompany services costs, monitoring the interim results, preparing adjustment entries, forecasting pricing changes, simulating possibilities, and maintaining supporting documentation and audit defence, to name a few, all of which entail detailed analysis. The need for all these activities to take place with reference to legal entity results (factoring in local Generally Accepted Accounting Principles and timing adjustments) creates significant additional complexity.

For example, consider an intercompany transfer price that needs to be updated for a specific product line or stock-keeping unit (SKU) based on a review of the latest quarterly financial results. This would, in turn, require analysing the cost and selling price of a given product at a global level as well as the entity level to ensure both the local and global margins of the product remain within policy guidelines. Furthermore, transfer pricing policy targets are typically set at an operating margin level, meaning indirect and overhead costs also need to be assigned or allocated at the product or even SKU level.

Demystifying transfer pricing execution and intercompany accounting

When combined with the need to forecast transfer pricing results – and not just monitor actual results – transfer pricing execution requires much more of an analytical technology framework than just the transactional system.

For companies that are setting up operations overseas for the first time, transitioning from a traditional transaction-based ERP system to an analytical and predictive model to support transfer pricing is nothing short of a financial transformation. Helping clients understand the magnitude of this transformation is where we at PwC start on a transfer pricing roadmap. Once a company grasps the concept from a global perspective, we can then help strategise at a local level to improve transfer pricing for each legal entity based on its tax requirements, products, and geography.

A monitoring framework

Today, there is an increasing need to monitor and evaluate changing conditions at different levels within the organisation. As a result, many ERP systems do not have the capability to monitor or evaluate changes on a real-time basis. To fill this gap, enterprise performance management (EPM) solutions extend the capabilities of ERP systems by offering real-time modelling. SAP's solutions for EPM provide a platform to build a fully integrated tax reporting solution for an ERP system (an SAP or non-SAP transactional system). SAP provides two applications – SAP Business Planning and Consolidation and SAP Profitability and Cost Management – either of which companies can deploy as a key component of an extensive platform for tax users to monitor and provide audit defence, as well as to enable the needed transparency into intercompany pricing policies and fluctuations. EPM applications such as SAP Business Planning and Consolidation and SAP Profitability and Cost Management can help solve the challenges inherent in any financial transformation to support transfer pricing policies by providing a multi-user,

Today, there is an increasing need to monitor and evaluate changing conditions at different levels within the organisation.

Demystifying transfer pricing execution and intercompany accounting

multi-language, and multi-currency environment where users can easily analyse and monitor data. SAP Profitability and Cost Management provides the business with a flexible and interactive experience in developing multiple financial models by centralising financial data. For example, the powerful calculation engine of SAP Profitability and Cost Management enables the analytical modelling of the information from SAP ERP to help support transfer pricing auditability.

SAP Business Planning and Consolidation and SAP Profitability and Cost Management are compatible with ERP transactional systems and data warehouses. In addition, both applications can accept data from non-SAP systems, which is usually a critical requirement for most multinational companies given their diverse system application landscapes. The decision of which solution to use to monitor transfer pricing rests on a company's overall enterprise architecture, system landscape, and other business processes in scope. Both applications can serve as transfer pricing engines, leveraging information flowing from ERP systems to support intercompany price-setting strategies that satisfy local tax jurisdiction regulations. Also, both solutions are highly integrated with Microsoft Office since many companies extract information from their enterprise systems into Microsoft Office tools.

An opportune time

Financial planning and analysis teams are looking for customer, channel, and product profitability, and cost to serve to all be fully loaded. So the opportune time is aligned not only to comments on US Security and Exchange Commission (SEC) reporting but also to other needs in the finance organisation. In many ways, transfer pricing is following the segmented financials reporting requirements in terms of how an organisation responds to increased external pressure, both from technological and strategic points of view. An ERP installation of a decade ago, for example, was ill-equipped for the automated segmentation of financial data that was needed to comply with SEC regulations, and manual workarounds were common until the release of the SAP New General Ledger Financial Planning rapid deployment solution with SAP ERP 6.0.

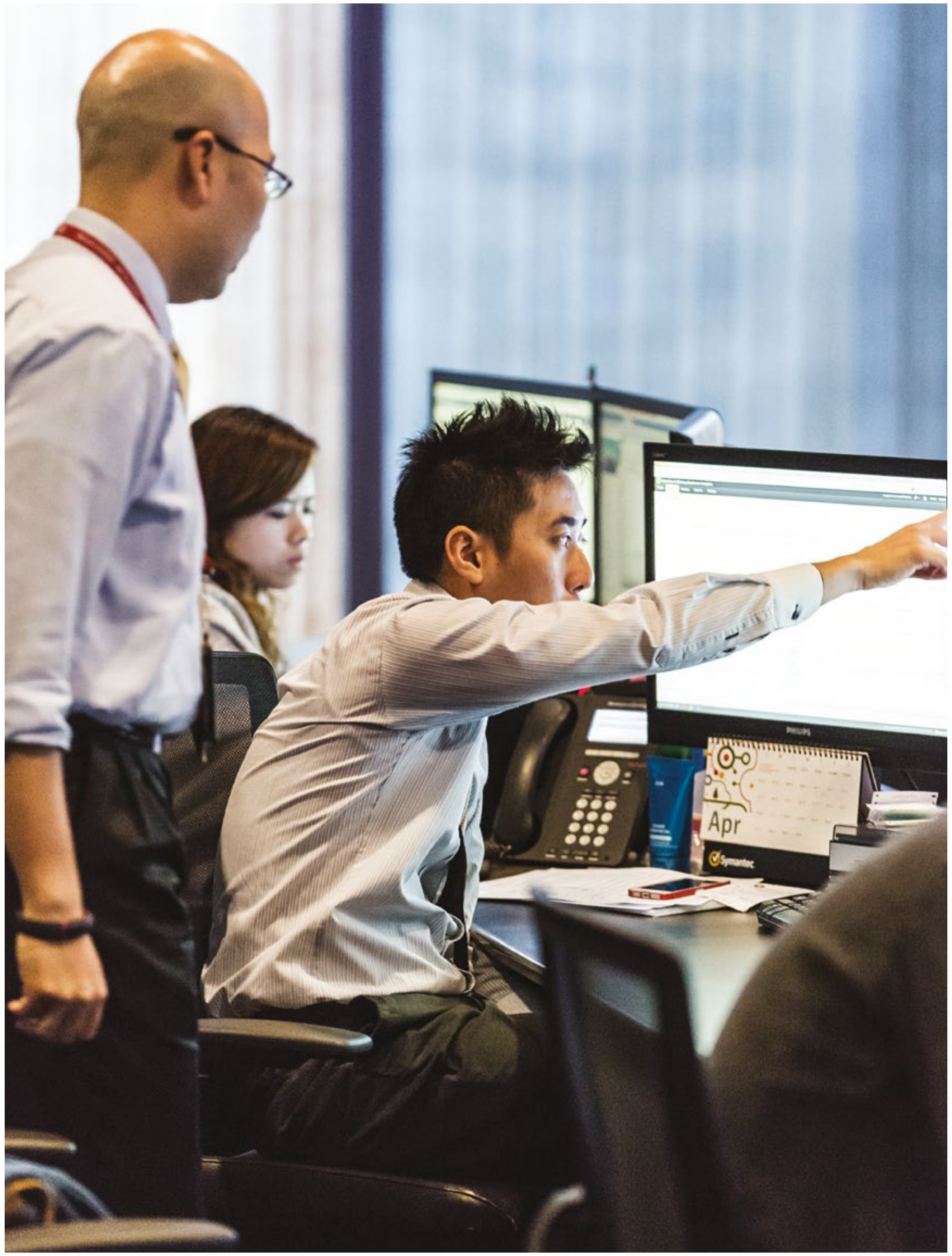
SAP Profitability and Cost Management provides the business with a flexible and interactive experience in developing multiple financial models by centralising financial data.

Demystifying transfer pricing execution and intercompany accounting

Similarly, with transfer pricing scrutiny on the rise, it is critical that an organisation design its ERP system so that it is the key data source for all information relevant for full transfer pricing transparency. Finance IT professionals need to involve tax department colleagues to understand any additional necessary reporting or data capture as the business evolves, enters new markets, or encounters tax law changes such as country by country reporting. Business planning and profitability applications now offer integrated solutions that can address complex tax and transfer pricing reporting requirements, and they provide an organisation with the confidence that it is engaging in international trade in a compliant and defensible manner.

The cost of non-compliance is too great to leave transfer pricing to chance.

The failure to comply with transfer pricing regulations can incur steep financial penalties. As such, IT professionals must work together within their companies, especially with tax, treasury, and finance, to guide the development and implementation of the integrated ERP and EPM solutions. The cost of non-compliance is too great to leave transfer pricing to chance.



This article appeared in the JAN FEB MAR 2015 issue of insiderPROFILES (insiderPROFILESonline.com) and appears here with permission from WIS PUBLISHING.

Demystifying transfer pricing execution and intercompany accounting

Authors

Andrew Hwang
PwC US
+1 646 471 5250
andrew.hwang@us.pwc.com

Sharabh Ivaturi
PwC US
+1 216 875-3056
sharabh.r.ivaturi@us.pwc.com

From startups to stalwarts: Transfer pricing in the technology sector

From startups to stalwarts: Transfer pricing in the technology sector

With each passing moment, the integration of the digital economy into the global economy is accelerating.

Something interesting is happening…

We are experiencing extraordinary times – revolutionary leaps in technology, new business models, and completely new ways of experiencing the internet. One the world's largest "taxi" companies, Uber, owns no vehicles. Facebook, the world's most popular media owner, creates no content. Alibaba, one of the world's most valuable retailers, has no inventory. And Airbnb, one of world's largest accommodation providers, owns no real estate.[1]

With each passing moment, the integration of the digital economy into the global economy is accelerating. Technology has moved well beyond a niche for geeks and gamers – it has now become the driving force propelling our society from the Industrial Age in to the Information Age. Major facets of our human existence – business, education, government, healthcare, and human interaction – are being dramatically reshaped by technology.

As a result of these societal and economic shifts, both private and public technology companies are cashing in. Technology companies

[1] Source: Tom Goodwin, Senior Vice President of Strategy and Innovation at Havas Media; http://techcrunch.com/2015/03/03/in-the-age-of-disintermediation-the-battle-is-all-for-the-customer-interface/#.p50if3:g9l7.

From startups to stalwarts: Transfer pricing in the technology sector

had a promising start to 2015 in the global financial markets, with 23 initial public offerings (IPOs) raising US$6.1 billion during the first quarter.[2] The second quarter of 2015 ushered in even stronger results, with 36 technology IPOs across 11 countries, with US$6.2 billion raised.[3] In particular, domestic exchanges in China saw a large number of IPOs during the first half of 2015.

Aside from the thriving IPO environment for global technology companies, courting investment in the private venture capital (VC) market has never been better. For private companies and startups pitching the promise of disruptive innovation, VC firms and other investors are lining up around the block to get a piece of the action. No one wants to miss out on the next Facebook. In an interview with the New York Times, Stewart Butterfield, co-founder of Slack, mused,

"It's pretty straightforward. I've been in this industry for 20 years. This is the best time to raise money ever. It might be the best time for any kind of business in any industry to raise money for all of history, like since the time of the ancient Egyptians."[4]

Being the first company in an industry to go IPO used to be an advantage, but today's market fuelled by strong investor interest and rising private valuation is causing some companies to stay private longer. As an example, in 2015 there was a significant drop-off in US technology IPO listings; this trend was driven by the abundance of late stage funding available to companies at 'unicorn' valuations and the delay of several IPOs by a number of venture backed technology companies.[5]

2 Source: http://www.pwc.com/globaltechipo
3 Id.
4 Source: http://bits.blogs.nytimes.com/2015/04/16/is-slack-really-worth-2-8-billion-a-conversation-with-stewart-butterfield/?_r=0
5 Alan Jones, Deals Partner at PwC

Being the first company in an industry to go IPO used to be an advantage, but today's market fuelled by strong investor interest and rising private valuation is causing some companies to stay private longer.

From startups to stalwarts: Transfer pricing in the technology sector

Unicorns and decacorns

Consider the unicorn. A majestic creature shrouded in myth and mystery, found in fables and folklore, characterised as impossible to capture alive and extremely rare. In a similar vein, cultivating a billion-dollar technology startup was once considered as rare and unlikely as spotting a unicorn.[6] But times have changed. There are now 111 private billion-dollar startups across the globe, compared to only 25 in 2013.[7,8] According to a list compiled by Forbes in May 2015, there are nine companies with valuations of more than ten billion dollars, and as a result, a new buzzword was born – the "decacorn".

It would be easy to dismiss this global explosion of companies with colossal 10 and 11 digit valuations as symptoms of a tech bubble poised to burst. After all, memories of the dotcom bubble burst of early 2000, which wiped out an estimated $4 trillion to $6 trillion of shareholder wealth,[9] and the 2008 global financial crisis, still haunt the collective consciousness of investors and economists alike. Yet despite the calamities of the not-so-distant past, investments into Internet-specific companies are at the highest level since the first quarter of 2001.[10]

Indeed, just as there are many similarities between the technology industry of today and that of the early 2000's (i.e., skyrocketing valuations, unprofitable companies going IPO), there are also fundamental differences. Some of these fundamental differences include companies: staying private for longer (the median technology company was 11 years old at its IPO in 2014, up from five years old in 2000);[11] amassing significant stockpiles of cash on their balance sheets; and having a focus on "lean" business models. Most importantly though, the ubiquity of the Internet and smartphone use has transformed the landscape of the global economy.

Widespread technological innovation and adoption has laid the foundation upon which digital products and services are now built. Technology is no longer a vertical industry, and technology companies are dead-set on disrupting almost every facet of society – from healthcare to transportation. As Marc Andreesen, cofounder of prominent Silicon Valley VC-firm Andreessen Horowitz, famously put it, "software is eating the world."

---

6 In fact, startups that manage to achieve valuations greater than one billion dollars are commonly referred to as "unicorns".
7 Source: http://knowledge.wharton.upenn.edu/article/is-a-tech-start-up-bubble-forming/
8 It should be noted that this figure includes companies across a number of industries, not just technology.
9 Source: http://www.pbs.org/wgbh/pages/frontline/shows/dotcon/thinking/stats.html
10 Source: http://www.pwcmoneytree.com/Reports/FullArchive/Technology_2014-3.pdf
11 Source: http://www.wsj.com/articles/more-startups-aim-to-keep-it-private-1420159193

From startups to stalwarts: Transfer pricing in the technology sector

Start-ups "move fast and break things"

What is a startup in today's world? By now we are all familiar with the fairy tale of the technology startup –They all seem to start the same way… "Once upon a time in a garage in Palo Alto."

Many would argue that startups are more mentality and methodology, attributes that can't be captured by any single measure or metric.

Major motion pictures such as "Jobs" and "The Social Network", and TV shows such as HBO's "Silicon Valley", have helped launch the term "startup", and the associated culture, in to the vernacular of the pop-culture mainstream. But despite the ubiquity of the term "startup", a precise definition proves difficult to nail down. The answer likely depends on who you ask.

According to Steve Blank, a Silicon Valley serial-entrepreneur and consulting associate professor of entrepreneurship at Stanford, a startup is "an organization formed to search for a repeatable and scalable business model."[12]

Paul Graham, head of celebrated Silicon Valley startup accelerator Y Combinator, comments, "a startup is a company designed to grow fast."[13] Graham maintains that it is not necessary for a company to work on technology or receive venture funding to be considered a startup, but rather he argues that a relentless commitment to growth is the single defining characteristic of a startup. He continues, "growth is why startups usually work on technology —because ideas for fast growing companies are so rare that the best way to find new ones is to discover those recently made viable by change, and technology is the best source of rapid change."[14]

Many would argue that startups are more mentality and methodology, attributes that can't be captured by any single measure or metric. "Move fast and break things," a motto immortalised and adopted by Facebook, but also echoed in numerous iterations by the majority of Silicon Valley technology startups.

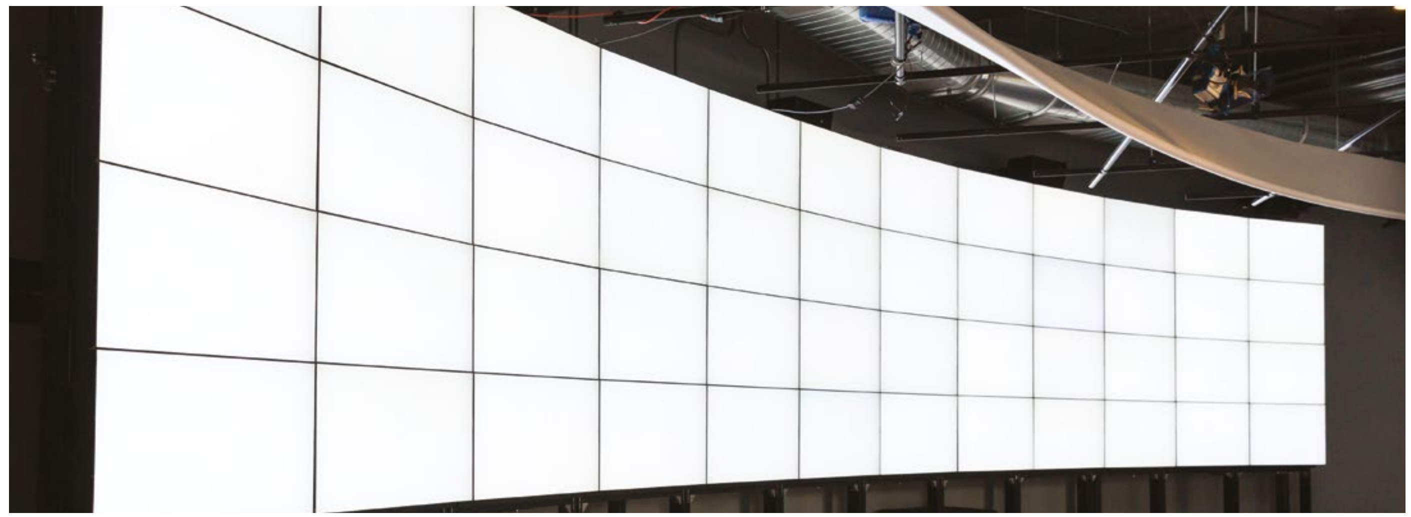
[12] Source: http://steveblank.com/2010/01/25/whats-a-startup-first-principles/
[13] Source: http://www.paulgraham.com/growth.html
[14] Id.

From startups to stalwarts: Transfer pricing in the technology sector

Made in Silicon Valley

Somewhat ironically, the epicentre of the economy's major tectonic shift from the Industrial Age to the Information Age runs in close proximity to the San Andreas Fault. Spanning from San Francisco's South of Market (SoMa) neighbourhood – a new bastion for software startups – to Stanford's hallowed halls of academia in Palo Alto, streaking through communities such as Mountain View, Sunnyvale, and Cupertino, all the way to semiconductor stalwarts stationed in sunny San Jose, this is where the action is; this is Silicon Valley. When it comes to the technology industry, the startup ecosystem in Silicon Valley is second to none.

A number of factors contribute to the success and effectiveness of startup ecosystems. First, the accessibility of talent, often driven by the proximity of higher-education institutions, allows



startups to assemble skilled workforces. With respect to Silicon Valley, universities such as Stanford, Berkeley, Santa Clara, and San Jose State provide startups a constant stream of young and ambitious skilled workers. However, startups can't survive on talent alone, especially with new college graduates, as these fresh faces need guidance and experience to navigate the challenges and risks that go along with starting a business.

Research from Shikhar Ghosh at the Harvard Business School indicates that 75% of all startups fail,[15] thus reinforcing the importance of experience within startup ecosystems. Over the past decade, experience within startup ecosystems has manifested itself not only in the form of seasoned founders and serial entrepreneurs, but also in the form of "angels" and "accelerators". Angels, or angel investors, are private investors that provide early stage startups with seed funding in exchange for equity, often filling the gap between the "friends and family" round and the more formal Series A venture funding

A number of factors contribute to the success and effectiveness of startup ecosystems.

[15] Source: https://hbr.org/2013/05/why-the-lean-start-up-changes-everything

From startups to stalwarts: Transfer pricing in the technology sector

round. Accelerators are typically three to four month programs offering small capital injections, mentorship and training designed to help entrepreneurs secure their first round of formal investment.

Ecosystems that provide access to talent and entrepreneurial support will facilitate the sprouting of startup success, but just as seeds need water in order to grow, startups need capital. The availability of capital and various forms of financing is fundamental to the success of the startup ecosystem – and it is a large part of what makes Silicon Valley the most dominant and successful startup ecosystem in the world. Even though startup ecosystems have expanded globally, Silicon Valley still has about as much capital and exit volume as the rest of the top 20 ecosystems combined.[16]

China on the rise

Beijing, Shenzhen and Shanghai have become Chinese hubs for innovation during the past few years. Tens of thousands of budding tech-savvy entrepreneurs have poured into the big three cities with dreams of changing China's economic future.

"Beijing, Shanghai and Shenzhen are the most economically dynamic regions in China," Zhao Guodong, secretary of Zhongguancun Cloud Computing Industry Alliance, said. "They edge other places in attracting the most ambitious and forward-looking entrepreneurs."

Of these three energetic cities, Beijing takes a lead by creating more than 120,000 startups every six months. Zhongguancun Science Park, commonly referred to as China's Silicon Valley, is home to nearly 20,000 tech companies, including internet giants such as Baidu Inc, JD.com and Xiaomi Corp.

Although Beijing already has a head start on other major cities such as Shanghai and Shenzhen, this could change in the future. "As other entrepreneurial centres continue to emerge in China, Beijing's advantage in the high concentration of venture capital will erode," noted Frank Hawke, China director for the Stanford Graduate School of Business, which runs the Stanford Ignite-Beijing Program for young entrepreneurs.[17]

In addition to Silicon Valley and China, successful startup ecosystems are flourishing in cities across the globe. New York, Los Angeles, Boston, Tel Aviv, London, Chicago, Seattle, Berlin, and Singapore all landed in the top 10 of the global startup ecosystem ranking.[18]

[16] Source: "The Global Startup Ecosystem Ranking 2015" Startup Compass Inc. with the support of Crunchbase.
[17] Source: http://www.chinadaily.com.cn/business/tech/2015-08/31/content_21754487.htm
[18] Source: "The Global Startup Ecosystem Ranking 2015" Startup Compass Inc. with the support of Crunchbase.

From startups to stalwarts: Transfer pricing in the technology sector

Innovation and IP intellectual property (IP)

Technology startups, regardless of company ethos or ecosystem of origin, all must maintain a constant focus on innovation in order to compete. Innovation comes in many forms. Some companies innovate by designing radically new solutions and developing new technologies. Other companies reconfigure or combine current technologies and create new markets through innovative applications of existing technology in a process called "combinatorial innovation".[19] For startups and even multinational corporations (MNCs) in the technology sector, just as the term "innovation" suggests transformation and rapid change, the processes of defining IP, setting up an appropriate business model or establishing a sustainable value chain are far from static. This fluidity, and the resulting uncertainty, presents challenges not only to company management and investors, but also to tax authorities, governments and policy makers worldwide that are concerned about getting their fair share of the profits.

The G20 and the Organisation for Economic Cooperation and Development (OECD) have explicitly sought to address the challenges of the digital economy as part of its Base Erosion and Profit Shifting (BEPS) project. In its deliverable relating to Action 1 of the BEPS project, the OECD recognised that 'the digital economy is increasingly becoming the economy itself', and therefore has not sought to ring fence the digital economy from the rest of the economy for tax purposes.[20] Rather, the OECD has sought to identify key features of the business models in the digital economy which are potentially relevant from a tax perspective.

[19] Source: http://www.economist.com/news/special-report/21593580-cheap-and-ubiquitous-building-blocks-digital-products-and-services-have-caused

[20] Source: OECD (2014), Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.

From startups to stalwarts: Transfer pricing in the technology sector

It is believed that up to 75% of the value of US public companies is now based on their IP (up from 40% in 1980)[22].

One key feature of business models in the digital economy is the disproportionately high importance placed on intangible assets in the global value chain, and the role of intangibles in increasingly integrated business models. The OECD views the investment in and development of intangibles as a core contributor to value creation and economic growth for companies in the digital economy.[21] It is believed that up to 75% of the value of US public companies is now based on their IP (up from 40% in 1980).[22]

While value attribution may not always be straightforward, it is certain that ownership of IP in general is a critical path to the success of many technology companies. With ever evolving business models, the IP for technology companies is constantly being updated. For many established technology companies, evolutionary and incremental innovation on existing proven IP displaces older technologies and brings to market newer technologies. The displacement rate may be faster or slower, depending on various factors, including IP protection available, ease to innovate around, market conditions, and business models, among other factors. On the other hand, startups that create emerging and radically disruptive technologies may still be in a random phase of discovery where creation of technology often takes erratic paths.

Such facts impact inputs into the transfer pricing analysis, including choice of economic useful life, growth parameters and discount rates. Understanding the unique innovation process of each company is key to the design of a robust IP transfer pricing policy. Like with everything else in transfer pricing, it is all about the facts.

[21] Source: OECD (2014), Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.
[22] Source: http://www.economist.com/node/5014990

From startups to stalwarts: Transfer pricing in the technology sector

"Important functions"

The approaches of tax authorities to identifying and taxing value drivers in these evolving business models is likely to be significantly influenced by the recommendations in relation to Action 8 of the BEPS project which broadens the focus in relation to intangibles from legal ownership to understanding the substance of the arrangements and which entities within the MNC group are performing the "important functions" associated with the legal and economic ownership of the intangible. These "important functions" include the development, enhancement, maintenance, protection and exploitation of the intangibles.[23] The OECD view appears to suggest that investments in IP creation, absent the important people functions that affect the IP, may not be of much value.

Technology companies seeking to support the substance behind models where significant economic value is attributed to a centralised legal owner of intangibles will need to specifically consider the above guidance in relation to its fact pattern. In particular, these MNCs should ensure they have sufficient personnel with the requisite expertise, capability and authority to perform the above "important functions", as well as considering the entity's financial capacity to perform the 'important functions'. Further, beyond the contractual arrangements, MNCs will need to ensure business processes and operating procedures are aligned to support the business model implemented, with appropriate substance and documentary evidence.

Got CUTs/CUPs?

The selection of a transfer pricing method always aims at finding the most appropriate method for a particular case.[24] In the past, we have seen technology companies employ one-sided profit models where routine profits are benchmarked and the remainder is deemed attributable to IP. In the context of new and non-traditional business models that have emerged in the digital economy, this approach is being increasingly challenged by tax authorities.

[23] Source: OECD (2014), Guidance on Transfer Pricing Aspects of Intangibles, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing.

[24] Source: http://www.oecd.org/ctp/transfer-pricing/45765701.pdf

From startups to stalwarts: Transfer pricing in the technology sector

Rather than wait for a global OECD-led solution, a number of countries have started to introduce unilateral actions.

The revised guidance from BEPS Action Plan No. 8 also brings forward a renewed interest by the OECD in actual observed behaviour of third parties when dealing with each other in matters involving IP. If such be behaviour can observed and reliably measured, it makes the comparable uncontrolled price (CUP) method likely to prove most useful in matters involving intangibles.

In practice, however, the difficulties of finding suitable comparable transactions where unrelated parties transfer rights to IP makes the CUP method extremely difficult to apply. Furthermore, once we move away from the one-sided profit model, the lack of observable standards of measurement opens the door for tax authorities to implement solutions that would be difficult to support or to refute. Nevertheless, on a periodic basis, MNCs should carefully review and understand any arrangements it may have with third parties involving the same IP rights that the MNC may also transfer to a related party. At a minimum, these arrangements provide insights into how the MNC transacts, negotiates and prices certain arrangements with third parties.

Unilateral measures

Technology companies in the digital economy have been able to break down many of the traditional barriers to integration, operating as global firms with integrated global value chains. Business models for MNCs in the digital economy have generally involved the centralisation of key functions, assets and risks at a regional or global level, along with the intangibles considered to drive value in the global value chain. This practice of centralising ownership of intangibles and attributing significant economic value to these intangibles in tax-favourable jurisdictions, along with significant in-country sales made by foreign entities, has resulted in more intense scrutiny of digital business models across the globe.

Rather than wait for a global OECD-led solution, a number of countries have started to introduce unilateral actions. Two announced unilateral measures which focus on addressing perceived challenges or mischiefs resulting from structures typically adopted in the digital economy are summarised below:

- United Kingdom (UK) Diverted Profits tax (DPT) – Draft legislation has been released in the UK in relation to a proposed DPT, which will tax at 25% profits that are considered to be artificially diverted from the UK. Whilst the measures are complex, in essence the DPT seeks to tax arrangements where income ends up in a related company with a low tax rate/ concessionary tax treatment.

From startups to stalwarts: Transfer pricing in the technology sector

These measures are proposed to apply to profits arising after 1 April 2015.

- Australia's general anti avoidance rules (GAAR) – A Bill has been introduced to Australian Parliament on 16 September 2015 with proposed targeted amendments to the GAAR rules aimed at structures designed to artificially avoid PE status. The measures are proposed to apply to income years commencing 1 January 2016.

Whilst the UK DPT arguably is broader in application, both measures address business models where goods and services are sold to local customers by an entity outside the local jurisdiction. The implications of these measures to typical digital business models will need to be considered carefully as the requirements for application of the provisions have been criticised as complex and subjective to apply, and the consequences of application of these unilateral measures could include double taxation and imposition of considerable penalties for MNCs.

Therefore, while companies operating in the digital economy will need to closely monitor and adapt their global business structures and transfer pricing policies in light of the BEPS recommendations, they will also need to be aware of the potential introduction of unilateral measures as public and political scrutiny continues to escalate.

From startups to stalwarts: Transfer pricing in the technology sector

Authors

Cecilia Lee
PwC Honkg Kong
+852 2289 5690
cecilia.sk.lee@hk.pwc.com

Marios Karayannis
PwC US
+1 408 817 7456
marios.karayannis@us.pwc.com

Daniela Ielceanu
PwC US
+1 408 817 5939
daniela.ielceanu@us.pwc.com

Lyndon James
PwC Australia
+612 8266 3278
lyndon.james@au.pwc.com

Hiral Mistry
PwC Australia
+612 8266 0683
hiral.mistry@au.pwc.com

Scott Singerman
PwC US
+1 408 808 2935
scott.a.singerman@us.pwc.com

Global transfer pricing documentation strategies

Global transfer pricing documentation strategies

The finalised Chapter V fundamentally changes the nature, scope and arguably purpose of transfer pricing documentation. Companies need to assess these changes and plan for the future. The time for deliberation is over, the time for action is now.

Where are we today?

The new Chapter V of the OECD Transfer Pricing Guidelines provides for three tiers of transfer pricing documentation (TPD): a master file (MF), a local file (LF), and a country by country report (CbCR).

In the last 12 months, we have seen the new Chapter V move closer to being implemented.

- In February 2015, implementation guidance was issued which clarified a number of the filing requirements for CbCR whilst also recommending that the MF/LF be filed with the relevant tax authorities in each territory.
- That was followed in June by an implementation package for CbCR containing model legislation for local tax administrations to give effect to CbCR and the related exchange of information provisions.

The Final Report on Chapter V has now been published, with limited changes to previous publications. To effect these fundamental changes most countries will still be required to amend their domestic legislation.

Global transfer pricing documentation strategies

We are now beginning to see tax administrations taking steps in this direction, for example, in the past six months:

- The UK became the first country to announce its intention to implement CbCR and has subsequently issued draft regulations to require CbCR.
- Spain became the first country to formally incorporate the requirements in full into local legislation.
- Australia, Mexico and Poland have published draft legislation for CbCR, MF and LF to be filed locally, with a new criminal offence for non-compliance (in Australia).
- China has released a discussion draft of proposed measures to include three-tier documentation (including specific documentation for services, cost sharing arrangements, and thin capitalisation) plus related party transaction reporting (including potentially CbCR).
- Singapore has released revised guidelines including a two tiered approach equivalent to the MF and LF.

In the past, as a result of the ad hoc development of TPD requirements around the globe, MNEs have often been faced with a myriad of different regulations, formats, and levels of prescription.

Accordingly, multinational enterprises (MNEs) and tax authorities alike are facing the dawning realisation that TPD will be fundamentally different as a consequence of the OECD's Base Erosion and Profit Shifting (BEPS) project. The changes are coming extremely fast and MNEs need to be ready for a post BEPS world.

Why do we need a global documentation strategy?

In the past, as a result of the ad hoc development of TPD requirements around the globe, MNEs have often been faced with a myriad of different regulations, formats, and levels of prescription. The traditional approach adopted by many MNEs in preparing their TPD has been designed to:

- ensure compliance with local documentation requirements;
- provide penalty protection, but at the same time;
- minimise the effort required.

This has often resulted in groups only preparing documentation for:

- those countries where there are prescriptive local requirements;

Global transfer pricing documentation strategies

- the tax authority is known to aggressively pursue transfer pricing audits; or
- where the transfer pricing risk associated with a particular affiliate is considered to be high.

The new Chapter V will profoundly affect the way MNEs approach the preparation of their TPD.

In the post BEPS world, a MNE will be required to disclose more quantitative and qualitative information (in the CbCR, MF and LF) to the tax authorities in, potentially, all the jurisdictions in which it has affiliates. In some countries, there will also be local transfer pricing information returns to be filed.

Under the 'secondary mechanism' recommended by the OECD, MNEs parented in jurisdictions that have not, or will not, implement the new Chapter V are not necessarily immune from the new requirements.

For example, Spain has essentially adopted Chapter V. Therefore MNEs with a Spanish entity (irrespective of whether the parent jurisdiction has implemented Chapter V) will need a CbCR (including data for the whole group) and a MF by the end of 2017. Now that the final papers have been issued, we expect more and more countries to adopt these requirements with Chapter V becoming the global standard incorporated within every MNE's documentation strategy.

As a result, the traditional approach will, we believe, shortly become a thing of the past. The preparation of TPD will shift from being purely a compliance exercise to being an inherent part of the MNE's strategic tax risk management.

Global transfer pricing documentation strategies

In this environment, MNEs will need a global strategy, and effective underlying processes, to deliver TPD which:

- ensures consistency between CbCR disclosures and the MF, LF and potentially local transfer pricing information returns (or at least enables the data in each document to be reconciled);
- includes a clearly articulated value chain analysis; and
- demonstrates that the group's policy has been followed, in practice, in the pricing of the inter-company transactions recorded in each group company's books.

With the increased amount of information that will be available to the tax authorities, we expect more coordinated multi-territory transfer pricing audits which could put a considerable strain on a MNE's resources. In these circumstances, TPD will be the first line of defence and will set the agenda for these discussions. It is therefore imperative that MNEs consider how their TPD presents their global business to the outside world.

What does that mean for me?

In short, a transition from the old world to a new world involving a higher risk of audit, more demands on a MNE's resources, and, in many cases, a significant shift in internal culture.

In the past, MNEs have taken a range of different approaches to the preparation of their TPD reflecting, amongst other things, their size and geographic coverage, their level of in-house transfer pricing resource, and whether they have a centralised or decentralised culture. With the harmonisation of the documentation requirements under the new Chapter V, we expect to see most MNEs move to a centralised approach to their TPD, whether that work is undertaken internally or outsourced. For MNEs which have traditionally adopted a decentralised approach, this may represent a significant change in culture.

With the increased amount of information that will be available to the tax authorities, we expect more coordinated multi-territory transfer pricing audits which could put a considerable strain on a MNE's resources.

Global transfer pricing documentation strategies

As more and more countries adopt the new requirements, MNEs (irrespective of where they are parented) need to monitor the legislative and tax authority developments in all the jurisdictions in which they operate to confirm if, and when, CbCR and/or MF filing obligations arise.

Many MNEs are already planning a smooth transition to the new world of the MF, LF and CbCR template. Indeed, a number of groups are now considering whether to disclose more information in documentation that they are preparing for accounting periods preceding the implementation of the new Chapter V.

The MNE's strategy should include an implementation plan. Whilst many countries have yet to go public on when they will introduce the new requirements, it would, in our view, be prudent for most large multinationals to plan on the basis that they will be required to comply with the CbCR, MF and LF requirements for accounting periods beginning on or after 1 January 2016.

To be able to plan for the future and develop a documentation strategy, MNEs have been assessing their current position by:

- reviewing their existing documentation – assessing what (more) will be needed going forward;
- modelling what the picture would look like now if the new rules applied – performing dry runs and addressing risks that have been highlighted;
- evaluating whether to take a "top down" or "bottom up" approach to CbCR (with the associated reconciliation issues that may arise with the local statutory accounts and information returns); and
- establishing what is possible – IT and internal resource capabilities.

Indeed we have anecdotal evidence of MNEs fundamentally changing their documentation approach and adding significant resource to their TP function.

When it comes to determining an appropriate strategy, we do not believe that there is a one-size-fits-all solution. MNEs have some flexibility in how they structure their TPD whilst still complying with the new requirements and it is for this reason that each MNE has to decide for itself what its documentation strategy should be.

It's time to take action

We know from MNEs and tax authorities that transfer pricing reporting in the post BEPS world will require more documentation, more disclosure, and more people/IT resources. Governments around the world are already starting to

Global transfer pricing documentation strategies

bring the OECD guidance into local law and now we have the final report it won't be long before the new framework becomes the global standard. There may be local variations and nuances but the direction of travel has been set. With the full involvement and commitment of the G20, along with countries such as China, India and South Africa, to this process, MNEs are coming to terms with the truly global implications of these new requirements.

In this post BEPS environment, MNEs will need a global documentation strategy, along with underlying systems and processes, to enable them to deliver consistent and robust TPD across all their affiliates and in line with statutory deadlines. On its own however, this is unlikely to be sufficient to allow a group to mitigate its audit risk – this requires strategic thinking to decide an appropriate level of qualitative analysis and how best to present sensitive information in your documentation.

To this end, MNEs should also be reviewing other areas subject to the BEPS spotlight including (but not limited to):

- The MNE's value chain analysis;
- The substance underlying the MNE's transfer pricing model; and
- The creation of permanent establishments.

Your TPD and in particular, your MF gives you the opportunity to disclose these matters in a way that minimises the risk of tax authority challenge.

Clearly there is a great deal to do in a relatively short period of time and for many MNEs, it will be essential to prioritise – to this end, the first step for MNEs has been to prepare a roadmap to take them from where they are today to where they want to be when the new requirements take effect.

The time for deliberation is over, the time for action is now.

In this post BEPS environment, MNEs will need a global documentation strategy, along with underlying systems and processes, to enable them to deliver consistent and robust TPD across all their affiliates and in line with statutory deadlines.

Global transfer pricing documentation strategies

Authors

Matias Pedevilla
PwC US
+1 305 347 3544
matias.l.pedevilla@us.pwc.com

Michael Walter
PwC Spain
+34 915 684 464
michael.w.walter@es.pwc.com

Kevin Jenkinson
PwC UK
+44 1223 552225
kevin.j.jenkinson@uk.pwc.com

Martin Kennedy
PwC UK
+44 1293 594646
martin.s.kennedy@uk.pwc.com

India transfer pricing – Steering in the right direction

India transfer pricing – Steering in the right direction

The Indian tax authorities are at the advanced stage of negotiations with Japan, United Kingdom and other European countries, with more bi-lateral agreements likely to be signed before 2015 ends.

For multinational enterprises (MNEs) with business operations in India, transfer pricing has been a significant issue in recent years. India has been perceived to have an aggressive and uncertain tax environment, with the Indian tax authorities having proposed billions of dollars in tax adjustments. Lately, however, India is moving towards a more taxpayer-friendly, non-adversarial tax regime, striving to become a mature tax jurisdiction. This is evident from various actions taken by the Indian government, which are not only likely to mitigate litigation but also improve the ease of doing business in India. Some of the prominent actions taken in the recent past are briefly described below.

Bilateral/Unilateral agreements

The Advance Pricing Agreement (APA) program was introduced to bring certainty and uniformity to transfer pricing matters and reduce protracted litigation. More than 550 applications have been filed in three rounds of filing with the APA authorities. With 15 unilateral and 1 bilateral APA and many more waiting for the final negotiation push, the program is certainly gaining momentum. The 16 signed APAs have been across industries and across issues. This would help get certainty on the litigation prone tax issues and avoid protracted litigation for these companies.

The first bilateral APA was entered into with Japan in December 2014. This is a major step towards improving the country's challenging investment climate. The Indian tax authorities are at the advanced stage of negotiations with Japan, United Kingdom and other European countries, with more bi-lateral agreements likely to be signed before 2015 ends.

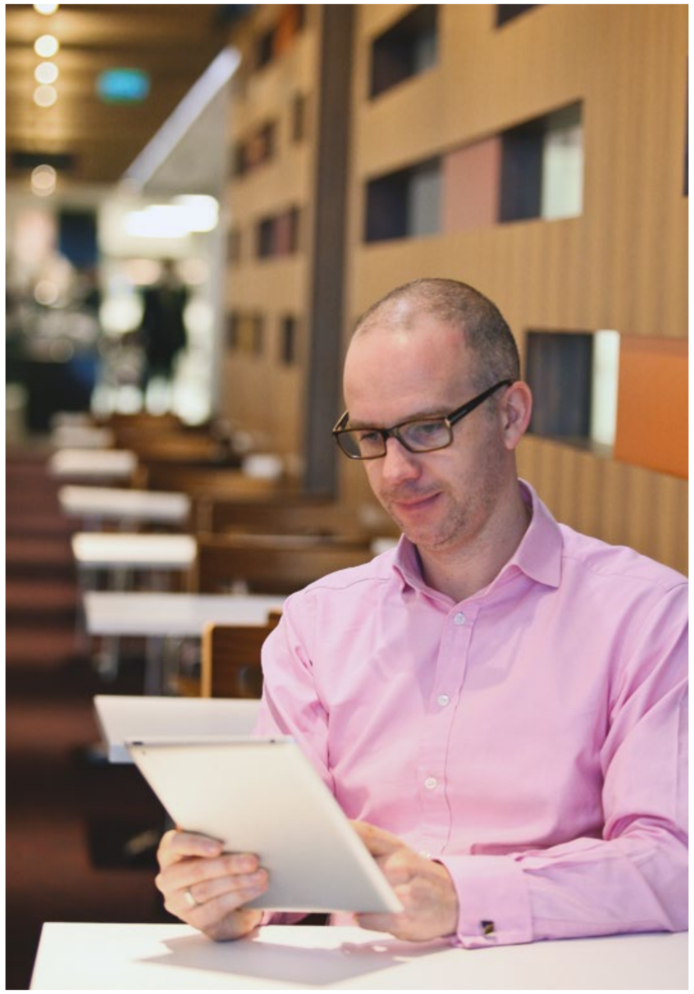
India transfer pricing – Steering in the right direction

To make the APA program more attractive for MNEs, the authorities have also introduced roll back option for the past four years. With this, the MNEs can now plan for a nine year horizon (five forward and four backward) for their key transfer pricing issues. Recently, one of the unilateral APA that was signed included roll back also.

Interestingly, after the roll back scheme was introduced, the Indian government sought feedback from the stakeholders and issued frequently asked questions (FAQs) thereafter, which reflects that the Indian government is empathetic and reactive to the concerns of the stakeholders.

The other mode which helps litigation on sovereign front, i.e. Mutual Agreement Procedure (MAP), has also seen positive developments. In early 2015, India and the United States agreed to work on and resolve the huge inventory of pending MAP cases in Information Technology (IT)/ IT Enabled Services (ITES) space. Resolution of these should pave the way for bilateral APAs between the United States and India. The MAP programs with Japan and UK are also progressing well with regular meetings and resolution of past disputes. The resolution of MAP cases may also open the door for some unilateral APAs which would be on similar issues.

With the APA count already in double figures and many others on the verge of finalisation, and MAP cases heading in the direction of resolution, the Indian government has demonstrated its intent of providing tax certainty. The transparency and proficiency with which such processes are being conducted is also reassuring.



The MAP programs with Japan and UK are also progressing well with regular meetings and resolution of past disputes.

India transfer pricing – Steering in the right direction

Setting precedents and limiting unproductive litigation

In November 2014, India's Central Board of Direct Taxes (CBDT) instructed income tax officers to more actively monitor and guide assessments and ensure more reasonable assessments with proper basis. The tax authorities were advised to utilise lengthy questionnaires or summons only after thoughtful consideration and not as a matter of routine. Taxpayers should also welcome the instruction that tax officers should not routinely litigate all matters and file appeals. Hopefully this will encourage issue resolution without judicial involvement.

Further, the Indian government's decision not to appeal the favourable (for the taxpayer) High Court transfer pricing ruling in the case of Vodafone India pertaining to the controversy around issue of shares, was a step towards limiting unproductive litigant and alleviating investor's concerns around prolonged tax disputes. Then the decision not to appeal the Shell India's case was reassurance of fact to sidestep unproductive litigation.

Speaking of precedents, the Indian High Court earlier in the year pronounced a landmark judgment on a marketing intangible issue for distribution subsidiaries in India. The case of manufacturing entities is also under litigation in the High Court and we can expect another development in the near future.

Fundamental reforms in transfer pricing

A key reform in India's transfer pricing regulations has been the recent proposition of permitting the use of arm's length range and multiple year data, as against the stringent arithmetic mean and use of only single year data. These changes were introduced by means of a draft scheme, to which the Indian government invited comments and suggestions of stakeholders and general public. This has clearly been perceived as being an inclusive and corroborative approach to dealing with key regulatory changes.

These reforms could significantly reduce the avoidable litigation burden in India for authorities and taxpayers. The alignment of Indian transfer pricing regulations with global best practices is an attempt to put India on a par with mature tax administrations. This is a paradigm shift from the position and perception of the Indian tax regime, which would build trust and enhance taxpayer's confidence.

Other balancing acts

The threshold for applicability of Domestic transfer pricing has been increased from INR 50 million to INR 200 million. This should reduce the compliance burden for small and medium domestic enterprises in India.

India transfer pricing – Steering in the right direction

Further, the government's decision to defer general anti-tax avoidance rules (GAAR) by two years while indicating that such rules should be aligned with the Organisation for Economic Co-operation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) recommendations is favourable. The Finance Minister also announced that it will avoid any retroactive tax provisions; welcome news for taxpayers. Also, the recent amendments can help avoid repetitive appeals as tax officers can opt not to litigate issues for which a High Court/ Supreme Court ruling already favours taxpayers. The clarification on indirect transfer taxation also provides some certainty on the controversial issue.

In the past, the Indian government introduced legislative reforms to expedite dispute resolution. Such reforms included introduction of an alternate dispute resolution mechanism. However, this mechanism faced certain challenges and as a result, the desired outcome was not achieved. With a resolve to making the mechanism effective, the CBDT revamped the entire mechanism. Earlier this year, the CBDT restructured the composition, jurisdiction, and control of the Dispute Resolution Panel (DRP) across the country. The revised structure includes five panels – two in Delhi, two in Mumbai, and one in Bengaluru. The restructured DRPs are comprised of dedicated commissioners to address conflicts of interest and ensure regular meetings and timely resolution of cases.

These actions once again reflect the Government's intent to boost economic growth, avoid aggressive taxation, and curb litigation.

The unfinished agenda

Although the APA (with roll back) mechanism will stimulate the reforms, it needs additional modifications in order to be more effective. Such modifications could include a more dynamic system whereby taxpayer feedback and global best practices are considered and implemented. The process, modalities and momentum of APAs are of utmost importance. Furthermore, India could expand the list of countries with which India could enter into bilateral APAs and MAPs to include Singapore, Germany, France, etc. Quickly closing APAs would also encourage more taxpayers to consider this option.

Finally, the existing safe harbour regime has not received a positive response from taxpayers. CBDT should relook at them and rationalize the safe harbour rules. Maybe the invitation of comments and suggestions of stakeholders and general public, could help align

These actions once again reflect the Government's intent to boost economic growth, avoid aggressive taxation, and curb litigation.

India transfer pricing – Steering in the right direction

these rules with the expectations of the taxpayers and gain acceptance.

The proposed scheme on the use of arm's length range and multiple year data is likely to create practical documentation complications for the taxpayers and audit challenges for both revenue and taxpayers. Though it is a positive move, but the final outcome should be in line with the global best practices.

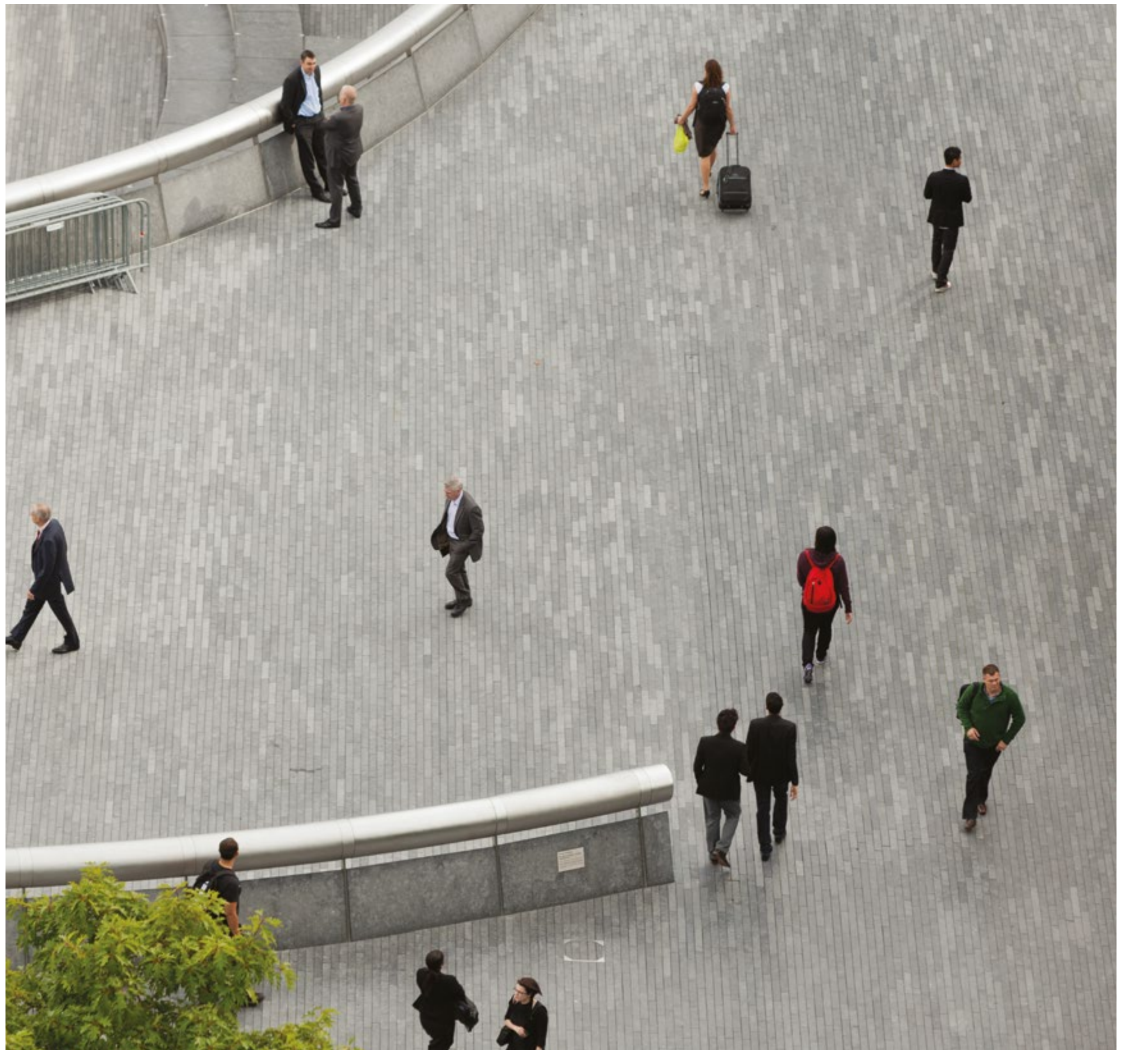
The Government, being part of G20, is also keen to introduce the country by country reporting (CbCR) rules effective April 2016. This should also refine certain transfer pricing policies in and relating to India.

On a separate note, other reforms like the unified Goods and Service Tax (GST) and new accounting standards, along the lines of International Financial Reporting Standards (IFRS), will be introduced soon. Since these would have an impact on reporting mechanisms and may warrant some changes in the business models, the implications of these reforms on transfer pricing policies would also need to be evaluated.

Conclusion

The common concern amongst MNEs has been that though there are many strategies, policies and tools formulated and various amendments made to the existing legal framework to address the uncertain and adversarial tax environment, proper implementation has been lacking. Thus, taxpayers eagerly await whether, and how, the Government's initiatives would alleviate their concerns on ground. Taxpayer's are hopeful that the Indian government would continue the current momentum and build upon all the positive steps taken so far, to address the litigious tax environment and improve the business community's perception of doing business in India.

Maybe the invitation of comments and suggestions of stakeholders and general public, could help align safe-harbour rules with the expectations of the taxpayers and gain acceptance.



India transfer pricing – Steering in the right direction

Authors

Sanjay Tolia
PwC India
+91 22 6689 1322
sanjay.tolia@in.pwc.com

Nitin Narang
PwC India
+91 124 330 6525
nitin.narang@in.pwc.com

Kuntal Sen
PwC India
+91 22 66891366
kuntal.sen@in.pwc.com

Ruhi Mehta
PwC India
+91 22 66891311
ruhi.mehta@in.pwc.com

Intercompany allocations of risk – transfer pricing considerations in a changing landscape

Intercompany allocations of risk – transfer pricing considerations in a changing landscape

Given the transfer of risk to the principal, the other party(s) to the transaction are entitled to a risk-adjusted return under the arm's length principle.

Introduction

A common planning feature of many multinational enterprise (MNE) transfer pricing structures is the reliance on a principal-service provider relationship.[1] Such relationships greatly reduce the complexity of intercompany pricing by enabling one party in a controlled transaction to bear risk associated with variability in profits (or losses). Limited risk arrangements of this type effectuate a transfer of (some element of) risk from one related party – i.e., the service provider – to the principal. Given the transfer of risk to the principal, the other party(s) to the transaction are entitled to a risk-adjusted return under the arm's length principle. When the principal in such an arrangement also owns the non-routine intangibles that represent the key value drivers within the organisation, the transfer pricing analysis distils down to a simple one-sided test in which the service provider is typically benchmarked using the Transactional Net Margin Method (TNMM).

With the release of its final report on actions 8, 9 and 10 as part of the project on base erosion and profit shifting (BEPS) titled Aligning Transfer Pricing Outcomes with Value Creation Actions 8-10 2015 Final Reports (the Report) and the

[1] The term "service provider" in this article is used generally to denote any entity that performs a well-defined set of functions that allows for a precise functional characterization of the entity (e.g., distributor, contract manufacturer, contract service provider, etc.).

Intercompany allocations of risk – transfer pricing considerations in a changing landscape

sections on risk (the Risk Section) and intangibles (the Intangibles Section) within the Report, the Organisation of Economic Cooperation and Development (OECD) has continued down the path previously outlined in other documents released as part of the ongoing project on base erosion and profit shifting (BEPS). A common theme in these documents is the OECD's emphasis on the performance of functions when looking to the allocation of risks and the returns attributable to such risk.

In light of the OECD's revised guidance on the issue, and the additional scrutiny this is likely to bring, successful defence of these structures will turn on two key points:

1. The ability to demonstrate proper substance with the principal i.e., control over the factors that influence the ability of the organisation to successfully generate value and to mitigate risk through effective risk management in a manner consistent with the contractual allocation of risk among the controlled parties; and,
2. The ability of the taxpayer to reliably identify, quantify and "price" the risk that is being stripped away from the service provider and assumed by the principal.

In this article we discuss how the OECD's position on intercompany allocations of risk, as set forth in the Risk Section of the Report and other related documents, will increase the challenge for taxpayers with regard to the first point. We then highlight an economic approach that is solidly grounded in economic theory and backed by empirical support which can help delineate the specific elements of risk that are transferred between parties via intercompany arrangements.

By identifying the nature of risks that are transferred between entities the economic framework helps inform the substance requirement/test.

Lastly, the approach can be directly applied by taxpayers to quantify and "price" the risk transferred away from the service provider.

Intercompany allocations of risk – transfer pricing considerations in a changing landscape

Emphasis on functional control

What constitutes an acceptable level of substance/control is a vast and uncertain continuum. The answer almost certainly turns on a case-by-case analysis that places great pressure on the ability of the taxpayer to systematically identify the value drivers and risks within the organisation. The table present on the right of this page summarises the emphasis on functional control over key risk mitigation or value creation activities as set out in the OECD's paper on business restructuring as well as the Risk Section and the Intangibles Section within the Report.[2]

An overarching theme in the Risk Section of the Report is the emphasis on "control" over risk for purposes of identifying the entity that assumes risk in the context of an intercompany transaction and, is thus, entitled to the return attributable to such risk. Furthermore, the OECD's guidance in this section ties the notion of control to the essential attributes of "capability" and "functional performance" within an entity.

Finally, the threshold question that must be answered in the affirmative for a transaction to be respected (e.g. not disregarded or recharacterised) per the Risk Section is whether the transaction exhibits the "commercial rationality of arrangements that would be agreed between unrelated parties." All of this makes for an environment where taxing authorities are not only more likely to recharacterise (i.e., disregard) transactions as originally structured by taxpayers but authorities on opposite sides of the same transaction can, by reference to the same guidance, take fundamentally opposed positions with regard to such characterisation.

Table 1: Summary of OECD guidance on substance/control

Business Restructuring Paper	Intangibles Section	Risk Section
Control of risk requires:	**To claim intangible related returns:**	**Management of risk requires:**
The capacity to make decisions to take on risk decisions to put the capital at risk	Perform and control important intangible-related functions and control other intangible-related functions performed by related and unrelated parties	The capability to make decisions to take on our decline a risk-bearing opportunity, together with the actual performance of the decision-making function
The capacity to make decisions on whether and how to manage the risk, internally or using an external provider	Bear and control risks and costs related to developing and enhancing the intangible	The capability to make decisions on whether and how to respond to the risks associated with the opportunity, together with the actual performance of the decision-making function
This will require the company to have employees or directors – who have authority to and effectively do, perform these control functions	Bear and control risks and costs associated with maintaining and protecting its entitlement to intangible related returns	The capability to mitigate risk, that is the capability to measure that affect risk outcomes, together with the actual performance of such risk mitigation
If outsourced, in order to control risk one has to be able to assess the outcome of the day-to-day monitoring and administration functions by the service provider.		

[2] Report on the Transfer Pricing Aspects of Business Restructurings, Chapter IX of the Transfer Pricing Guidelines, 22 July 2010, OECD. The Risk Section and the Intangibles Section within Aligning Transfer Pricing Outcomes with Value Creation Actions 8-10: 2015 Final Reports, 5 October, 2015, OECD. These documents/sections are referred to as the Business Restructuring Paper, the Intangibles Section and the Risk Section, respectively.

Intercompany allocations of risk – transfer pricing considerations in a changing landscape

Risk and measurement

The guidance in the Risk Section of the Report appears to reflect the OECD's view that taxpayers may have been too quick in attributing risk, and the return associated with such risk, to specific members of the MNE group (i.e., the principal). For instance, in its draft paper titled BEPS Actions 8, 9, and 10: Discussion Draft on Revisions to Chapter I of the Transfer Pricing Guidelines (including Risk, Recharacterisation and Special Measures - a precursor to the Risk Section - the OECD had stated that, "[b]lanket statements that one or another party performing commercial activities is insulated from all commercial risk and that pricing should be based on the determination of risk-free returns should be carefully scrutinised (pp 49)." Hence, the evolving landscape requiring taxpayers to carefully parse which members of the group manage risk (via substance) in order to assess the relative import of each member's value contribution also means that taxpayers will need to refine their approach to the actual measurement of risk for purposes of determining proper arm's length pricing.

An approach for quantifying intercompany transfers of risk developed by the authors can help taxpayers support limited risk intercompany arrangements across both dimensions of scrutiny.[3] The approach is grounded in a substantive body of work in finance that analyses the determinants of a company's systematic risk. This literature is used to derive a framework to identify the specific type of operational risk that can be transferred between parties by means of an intercompany contractual arrangement and also distinguish such "transferable risk" from other elements of operating risk. In particular, the framework allows for the decomposition of the risk faced by a service provider into two factors. Of these, the risk associated with the firm's revenue generating process is an intrinsic business risk that cannot be transferred away by means of an intercompany arrangement. In contrast, the "transferable risk" is identified as the risk that stems from operating leverage, a characteristic that derives from the firm's operating cost structure in which the presence of fixed costs play the role of magnifying the intrinsic business risk faced by the firm. By providing a fixed level of profitability, expressed in terms of a fixed multiple of some economic variable (e.g., sales, operating expense, etc.), to the service provider, the intercompany arrangement has the effect of altering (lowering) the entity's operating leverage and its risk exposure that stems from such leverage.

[3] See Singh, K and W. J. Murphy, "An Approach to Quantifying Intercompany Transfers of Risk," Tax Management Transfer Pricing Report, October 29, 2014, Volume 23, Number 13.

Intercompany allocations of risk – transfer pricing considerations in a changing landscape

The risk quantification framework based on operating leverage addresses key challenges that taxpayers can expect to face when defending their limited risk arrangements in the face of the OECD's evolving guidance on the issue.

The risk quantification framework based on operating leverage addresses three key challenges that taxpayers can expect to face when defending their limited risk arrangements in the face of the OECD's evolving guidance on the issue:

1. By clearly and objectively delineating the "transferable risk" faced by a functional entity from its overall operational risk, the approach directly addresses the OECD's critique of taxpayers' positions with regard to "blanket statements" on entities being ' "insulated from all commercial risk" under principal-service provider arrangements.
2. By identifying the true economic nature of this "transferable risk" and its underlying cause i.e., operating leverage, the approach can help better guide taxpayers' efforts toward ensuring that the principal has the requisite substance/control with regard to such risk.
3. The framework provides a robust and defensible quantitative methods for purposes of "pricing" the "transferable risk" in terms of a "risk adjustment" that can be applied to benchmark returns observed among independent companies that are functionally comparable to the related party service provider but which differ in their risk profile.

Taking this framework one step further, we have used its conceptual underpinnings to empirically quantify the risk-reward trade-off observed for independent companies. Using data for a sample of independent distributors in the United States over a 16-year horizon we have estimated what percentage of these companies'

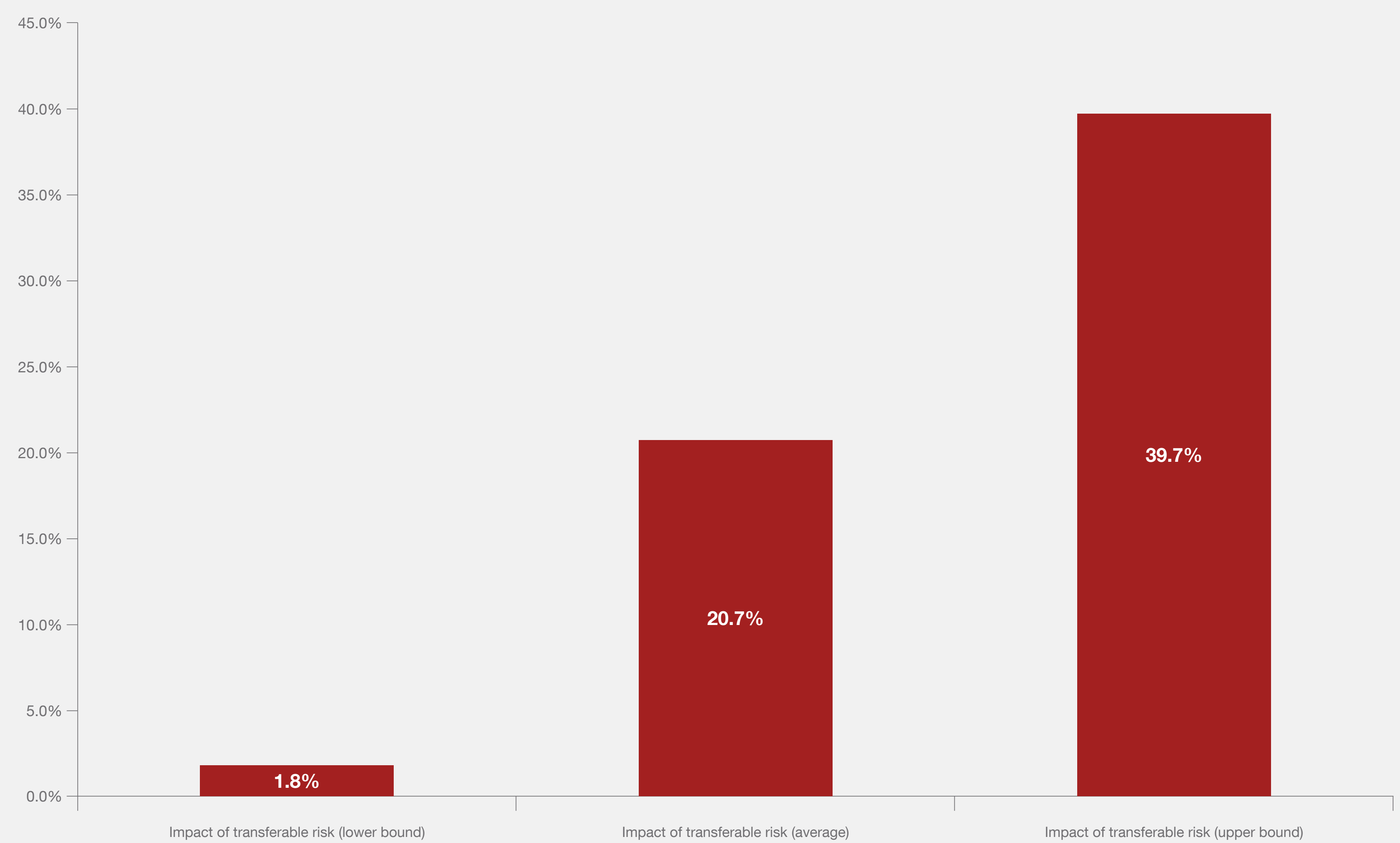
Intercompany allocations of risk – transfer pricing considerations in a changing landscape

observed operating margins (OM) is attributable to "transferable risk" (in the meaning of the framework described above). The empirical strategy applies an econometric approach that "controls" for observed as well as latent firm-specific attributes as factors that have a bearing on the firms' OM results. The strategy thus allows us to "isolate" the specific relationship between "transferable risk" and firm profitability(as measured by its OM). The figure present on the right of this page summarises some of the key results from the analysis.

The empirical results show that, on average, approximately twenty percent of the observed OM results of US distributors can be attributed to the type of risk that is typically stripped away under a limited risk intercompany arrangement.

The analysis suggests that the target OM for a "limited risk distributor" should be lower than the OM observed for a functionally comparable independent distributor by a factor of 20 percent, on average. The empirical analysis, which applies the concepts of the risk quantification framework described on the previous page, can be extended to other industries (e.g., manufacturers, service providers, etc.) and provides compelling economic support for

Figure 1: Impact of transferable risk on the operating margin results of US distributors (1999-2014)



Intercompany allocations of risk – transfer pricing considerations in a changing landscape

The evolving regulatory landscape shaped by the OECD's BEPS project will put significant additional pressure on a widely used class of intercompany arrangements.

the risk-reward trade-off that is directly relevant for taxpayers in the defence of limited risk intercompany arrangements.

Conclusion

The evolving regulatory landscape shaped by the OECD's BEPS project will put significant additional pressure on a widely used class of intercompany arrangements. In particular, taxpayers' successful defence of "principal-service provider" arrangements where the service providers earn stable and (relatively) low returns will depend crucially on two factors, the ability to demonstrate that the principal possess the requisite control/substance over the specific risk it contractually bears and a methodology that can quantify such risk under a reliable and defensible application of the arm's length principle.

This article outlines a methodological approach whose conceptual underpinnings and empirical application can help taxpayers in both these objectives.

Intercompany allocations of risk – transfer pricing considerations in a changing landscape

Authors

Joe Murphy
PwC US
+1 617 530 4289
w.joe.murphy@us.pwc.com

Kartikeya Singh
PwC US
+1 703 918 3290
kartikeya.singh@us.pwc.com

Navigating the changing transfer pricing landscape for the energy industry

Navigating the changing transfer pricing landscape for the energy industry

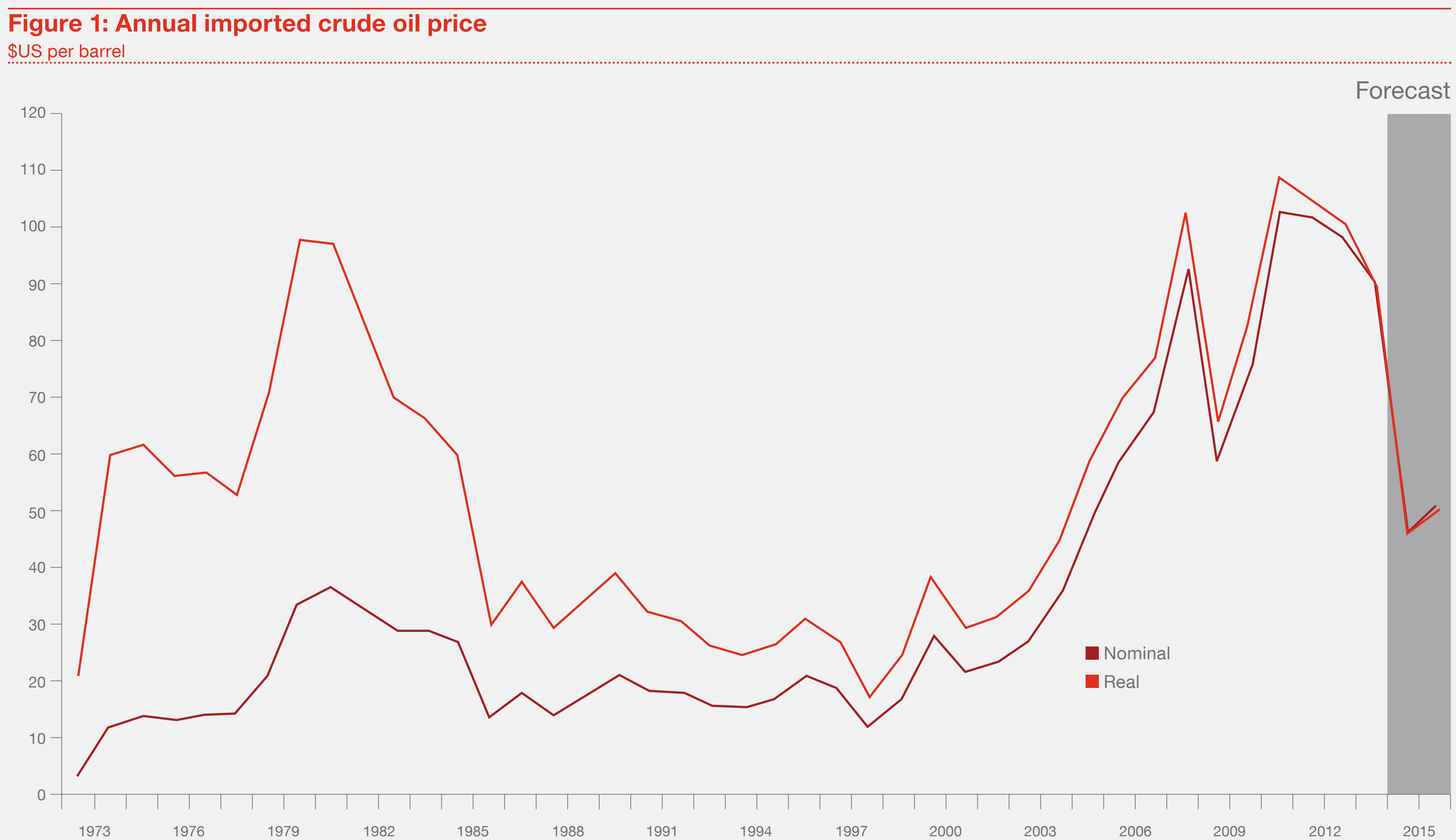
Introduction

Until recently the energy industry received relatively little attention from many tax authorities, at least outside a handful of significant energy producing countries such as Australia, Canada, Norway and the UK. Scrutiny of transfer pricing issues in many developed countries increased rapidly through the 1990s and early 2000s, although much of that attention focused on industries other than energy such as consumer and industrial products, technology and financial services.

However, energy transfer pricing is now increasingly in the spotlight, evidenced by an increase in industry-specific legislation (e.g. Brazil's transfer pricing rules on exports of commodities)[1] and guidelines and tax authority enquiries. This is hardly surprising given the combination of recent high commodity prices, which generated record profits for the industry, and widespread government fiscal deficits.

The diagram below illustrates the timing and extent of the recent oil price boom – notably a number of the highest oil price years (2010-14) occurred after the global financial crisis when governments were most fiscally constrained.

Figure 1: Historic and forecast price for crude oil imported into the US – 1973 to 2016



Source: EIA, Short Term Energy Outlook, (http://www.eia.gov/forecasts/steo/realprices/)

[1] Quotation Price on Exports method (PCEX) introduced by Law 12715/12

Navigating the changing transfer pricing landscape for the energy industry

The BEPS Action Plan addresses several areas of significance to energy companies (in particular, the relative contributions of risks, capital, and personnel to the value chain) and raises questions as to whether established structures within the industry will continue to be respected from a tax perspective.

Other factors have contributed to the recent surge in interest in energy transfer pricing, including:

- the technology-driven surge of unconventional oil and gas production;
- a rapid growth in liquefied natural gas (LNG) projects;
- the emergence of new markets and new producing countries (e.g. in Africa); and
- the increasing attention paid to transfer pricing by the governments and tax authorities of developing countries, a number of which are major energy producers.

The above developments sit against a backdrop of the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) Action Plan.[2] The BEPS Action Plan addresses several areas of significance to energy companies (in particular, the relative contributions of risks, capital, and personnel to the value chain)[3] and raises questions as to whether established structures within the industry will continue to be respected from a tax perspective.

As part of the BEPS Action Plan, the OECD has also published a commodity specific paper for the first time.[4] Further, a task force from the OECD and the World Bank Group is performing commodity-specific supply chain reviews as a part of the Tax and Development Programme.

[2] OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing. (http://dx.doi.org/10.1787/9789264202719-en)
[3] OECD BEPS Actions 8, 9 and 10, Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10: 2015: Final Reports.
[4] OECD BEPS Actions 8, 9 and 10, Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10: 2015: Final Reports

Navigating the changing transfer pricing landscape for the energy industry

Transfer pricing changes across the energy value chain

The previously mentioned developments constitute a challenging transformation for the industry from a transfer pricing perspective. The remainder of this article discusses components of the energy industry value chain which are particularly affected by recent developments, i.e. financing arrangements; cross border leasing of mobile assets; and the marketing and trading of energy products.

Intercompany funding

To fund exploration and development activities, energy producers need substantial amounts of funding. Commonly this is at least partly in the form of debt from related parties. For large energy projects, e.g. new LNG developments, the funds required can run to many billions (or even tens of billions) of dollars.

Tax authorities in many countries are increasingly paying close attention to the transfer pricing aspects of funding arrangements for energy projects, including interest rates on debt from related parties, parent guarantee fees on debt from third parties, and the amount of debt (in those countries where the arm's length principle governs the allowable amount of debt). Putting aside the industry-specific issue of interest-free funding of exploration activities (quasi-equity), which has long attracted interest from tax authorities in territories providing funding, the 'new normal' also affects funding of production activities which can afford interest payments.

On multi-billion dollar loans such as those common in the energy industry, the interest and guarantee fee amounts at stake can be very substantial. In countries such as Australia and Canada this has led to increasingly technical debates on how to establish an arm's length 'price' for funding and parental guarantees, including how to determine the credit quality of the borrower and the extent to which 'parental affiliation' (i.e. the credit rating of the group parent company) should be taken into account, if at all.

BEPS Action 4, which seeks to limit base erosion via interest deductions and other financial payments, threatens to change the

To fund exploration and development activities, energy producers need substantial amounts of funding. Commonly this is at least partly in the form of debt from related parties. For large energy projects, e.g. new LNG developments, the funds required can run to many billions (or even tens of billions) of dollars.

Navigating the changing transfer pricing landscape for the energy industry

game even more radically with a new a one-size-fits-all approach. The OECD has suggested two types of tests (fixed ratio rule as the primary test, and group ratio rule as optional test) to limit interest deductions, which move away altogether from the arm's length principle in its current form.[5]

The proposed primary fixed ratio rule has been confirmed with a range of acceptable EBITDA thresholds for countries to adopt between 10% and 30%. The OECD also identifies various factors which it hopes will help countries set the appropriate ratio. On the other hand, a group ratio rule, which could be adopted alongside the fixed ratio rule, would allow for net interest expense above a country's fixed ratio to be deductible up to the level of the net interest/EBITDA ratio of its worldwide group.

Companies which own and use mobile assets to provide services, e.g. mobile offshore drilling units, platforms and floating production vessels, have long used separate legal entities to own and lease the assets to the entities that crew and operate them.

In light of this OECD recommendation, it will be important for energy companies to closely monitor further developments (both at global and local country levels) and be prepared to respond to changes in rules or practices which may impact their existing funding arrangements.

Mobile assets

The developments discussed earlier have affected not only

energy exploration and production companies, but also service providers to the industry such as drilling services companies.

[5] OECD/G20 Base Erosion and Profit Shifting Project, Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4: 2015 Final Report

Navigating the changing transfer pricing landscape for the energy industry

Companies which own and use mobile assets to provide services, e.g. mobile offshore drilling units, platforms and floating production vessels, have long used separate legal entities to own and lease the assets to the entities that crew and operate them. The asset owning entities commonly lease the assets to the operating companies. Such operating structures can assist with asset protection and facilitate the frequent movement of mobile assets between countries with minimal commercial, legal and regulatory impediments.

Historically, the transfer pricing methodologies used in the industry have recognised the substantial value contributed by these specialised, high value assets, and the significant market and utilisation risks commonly attached to asset ownership. Under conventional transfer pricing principles, these contributions are reflected in the asset owner's share of profits.

Although BEPS Actions 9 contains extensive discussion and guidance on analysis of risks (and the resulting allocation of profits to those risk), OECD suggests that it should not be interpreted as indicating that risks are more important than functions or assets.[6] Instead, the expanded guidance on risks and examples around the transfer pricing of mobile assets reflect the practical difficulties presented by risks:
risks in a transaction can be harder to identify than functions or assets, and determining which associated enterprise assumes a particular risk in a transaction will require careful analysis.
This is an important consideration, especially for companies operating in this industry, given the historical transfer pricing method used have recognised the substantial value of the assets and the significant risks associated with asset ownership (e.g. utilisation).

To effectively manage transfer pricing risk in value chains where mobile assets and associated risks are key value drivers, companies will increasingly need to take a whole-of-value chain approach to evaluating and documenting those arrangements. This will require careful evaluation of the functions performed throughout the value chain including the functions associated with the ownership of the assets, and careful and thorough assessment of where key risks lie within the value chain.

Centralised marketing/trading

Although it is common for energy companies to centralise their marketing/trading activities in one or a few locations, many tax authorities (of both developing and

[6] OECD/G20 Base Erosion and Profit Shifting Project, Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10: 2015: Final Reports

Navigating the changing transfer pricing landscape for the energy industry

developed countries) are looking at these with increasing scepticism. For example, the tax authorities in Australia have closely examined not only the pricing of product sales to offshore 'marketing hubs' and the amount of profit residing in the hub, but also the commercial justification for the arrangements.

Similarly, the BEPS Action Plan has targeted situations where transfer pricing outcomes are not aligned with the value creating functions.[7] The OECD has also introduced revisions to its Transfer Pricing Guidelines, with particular emphasis on delineating the transactions in line with the actual behaviour of the parties, pricing of commodities related transactions and the allocation of risk, (i.e. to assume a risk, an entity needs to control the risk and have the financial capacity to assume the risk), by including multi-step approach to dealing with risk for transfer pricing purposes.[8]

The BEPS Action Plan has also increased the threat of reconstruction of transactions (e.g. by disregarding the contractual allocation of risk where it is at odds with the substance of the arrangement) and non-recognition of transactions. As demonstrated by the Australian experience, these OECD developments may cause tax authorities to overlook the contractual allocation of risk to marketing/trading operations if those operations do not also manage the risk and have the capability to influence the risk.

In the United Kingdom (UK), the diverted profits tax (DPT) regime also has the potential to affect energy companies with offshore marketing hubs. The DPT is a 25% tax on profits that are considered to be artificially diverted from the UK.[9] The focus of DPT is on issues of substance and permanent establishment (PE), which can be challenging to address in the energy markets because of complex global supply chains, unique trading activities and highly mobile traders.[10] The UK tax authorities have also scrutinised more complex arrangements seen in the industry such as fixed-for-floating/total return swaps – they have reviewed a number of these and concluded that some might be regarded as profit transfer arrangements.[11]

In light of the above developments, it is critical that energy companies be prepared to defend against substance-based challenges to the amount of profit returned by their marketing/trading operations.

[7] OECD/G20 Base Erosion and Profit Shifting Project, Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10: 2015: Final Reports
[8] Ibid, para. 1.60
[9] PwC, Tax Insights, UK Diverted Profits Tax to be introduced, 12 December 2014
[10] HM Revenue & Customs, Diverted profits Tax: Interim Guidance, March 2015 (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/422184/Diverted_Profits_Tax.pdf)
[11] HM Revenue & Customers, Guidance on avoidance schemes involving the transfer of corporate profits, guidance on legislation published on 19 March 2014.

Navigating the changing transfer pricing landscape for the energy industry

Disclosure developments relevant to the energy industry

The energy industry is facing a rapid increase in tax and transfer pricing disclosure requirements. For example the 'transparency' pillar of the OECD's BEPS Action Plan has recommended a new 'three-tier' framework for transfer pricing documentation for multinationals, comprising a country-by-country report (CbCR), a master file and local files.[12] A number of countries have already confirmed they will implement the new measures, including the UK,[13] Spain[14] and Australia.[15]

The OECD three-tier reporting framework will apply to all industries while other compliance regimes like the Extractive Industries Transparency Initiative (EITI) standard, which was rolled out in May 2013 (and revised in January 2015),[16] are more specific to the energy industry. The EITI is a voluntary mechanism

		EITI Framework	EU Transparency Directive	OECD CbCR
Names of establishments, nature of activities and geographical location		x	x	✓
Payments to government	Production entitlement	✓	✓	x
	Profit taxes e.g. corporate income tax	✓	✓	✓
	Other taxes on income, profit or production	✓	✓	x
	Royalties	✓	✓	x
	Dividends	✓	✓	x
	Production, signatory, discovery and other bonuses	✓	✓	x
	Licence fees, rental fees, entry fees	✓	✓	x
	Infrastructure payments	✓	✓	x
	Social expenditure	✓	x	x
	Public subsidies received	x	x	x
Production volumes		✓	x	x
Revenues		x	x	✓
Number of employees (Full Time Equivalent)		x	x	✓
Profit or loss before tax		x	x	✓
Stated capital		x	x	✓
Accumulated earnings		x	x	✓
Tangible assets		x	x	✓

[12] OECD/G20 Base Erosion and Profit Shifting Project, Transfer Pricing Documentation and Country-by-Country Reporting, Action 13: 2015: Final Report
[13] PwC, Tax Insights, UK to introduce legislation to implement country-by-country reporting, 15 January 2015
[14] PwC, Tax Insights, Spain: Government announces intent to adopt country-by-country reporting requirements, 27 January 2015
[15] PwC, Tax Insights, Draft law released for Australian Country-by-Country and Master/Local File Reporting, 7 August 2015
[16] Extractive Industries Transparency Initiative, The EITI Standard, EITI International Secretariat – 1 January 2015 (https://eiti.org/files/English_EITI_STANDARD.pdf)

Navigating the changing transfer pricing landscape for the energy industry

promoting governance in resource-rich countries through the publication and verification of company payments and government revenues from oil, gas and mining.[17] To complement the EITI, the European Union (EU) introduced mandatory disclosure requirements for extractive and logging industries by requiring companies registered or listed in the EU to disclose payments to governments along the same lines as the EITI.[18] Those hoping for interchangeability of the information in these three regimes might be surprised by a simple summary presented on the previous page.

Key takeaways and outlook for the future

The energy industry is experiencing an unprecedented array of changes to the transfer pricing landscape. While some of the challenges faced are common to all industries, arguably the energy industry is facing even greater change than many. Companies in the industry are facing increased scrutiny of the 'substance' of arrangements and of the pricing of 'mobile' value contributions such as financing and asset leasing. The emerging OECD doctrine of 'functions first' creates challenges in applying transfer pricing principles in an industry dominated by large capital investments and substantial risk.

Successfully navigating these changes will require stock-taking of transactions to identify those most likely to attract attention (such as the examples provided in this article). In some cases, the substance and pricing of existing arrangements may need to be re-evaluated, to stress test if they continue to be sufficiently robust to sustain challenge.

[17] The Australian Extractive Industries Transparency Initiative Pilot Multistakeholder Group report (http://www.industry.gov.au/resource/Programs/ExtractiveIndustriesTransparencyInitiative/Pages/default.aspx)

[18] New disclosure requirements for the extractive industry and loggers of primary forests in the Accounting (and Transparency) Directives (Country by Country Reporting) – frequently asked questions. (http://europa.eu/rapid/press-release_MEMO-13-541_en.htm)

Authors

Hamish McElwee
PwC Australia
+61 8 9238 3571
hamish.j.mcelwee@au.pwc.com

Dale Bond
PwC US
+1 713 356 4156
dale.bond@us.pwc.com

Szymon Wlazlowski
PwC UK
+44 207 212 1889
szymon.wlazlowski@uk.pwc.com

Ivan Williams
PwC Canada
+1 403 509 7554
ivan.p.williams@ca.pwc.com

Taking the lead – Reform to Australia's transfer pricing landscape in a global context

Taking the lead – Reform to Australia's transfer pricing landscape in a global context

Introduction

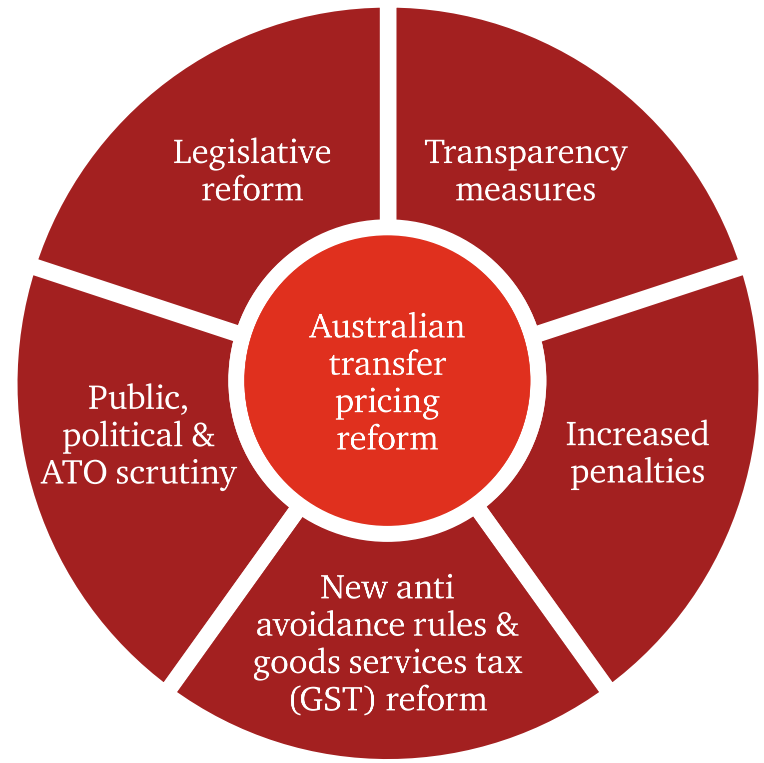
As the G20 and Organisation for Economic Co-operation and Development (OECD) drive the reform agenda for the international tax and transfer pricing landscape through the Base Erosion and Profit Shifting (BEPS) project, Australian Treasury and the Australian Taxation Office (ATO) have continued to play a key role in influencing the global debate and leading the charge in implementation of proposed reforms. The level of political and public scrutiny of tax paid by multinational enterprises (MNEs) in Australia has also continued to increase, exemplified by the Senate Inquiry into corporate tax avoidance which is due to release its report in relation to transfer pricing in November 2015.

In this context, MNEs operating in Australia have experienced a complete re-write of the transfer pricing law, coupled with an increasing focus from the ATO in monitoring compliance and enforcing the law.

This article provides a summary of the key recent legislative, ATO, and other political developments relevant to MNEs operating in Australia (summarised diagrammatically below), and our recommendations for taxpayers wanting to mitigate their risk of an ATO transfer pricing review/audit and associated penalties.

Legislative reform

MNEs operating in Australia are subject to new transfer pricing legislation,[1] which applies to income years beginning on or after 1 July 2013. The legislative reforms, which follow the decision in a landmark transfer pricing case in Australia,[2] are intended to 'modernise' Australia's transfer pricing rules and align them with the OECD model tax treaties and transfer pricing guidelines, with some notable exceptions.



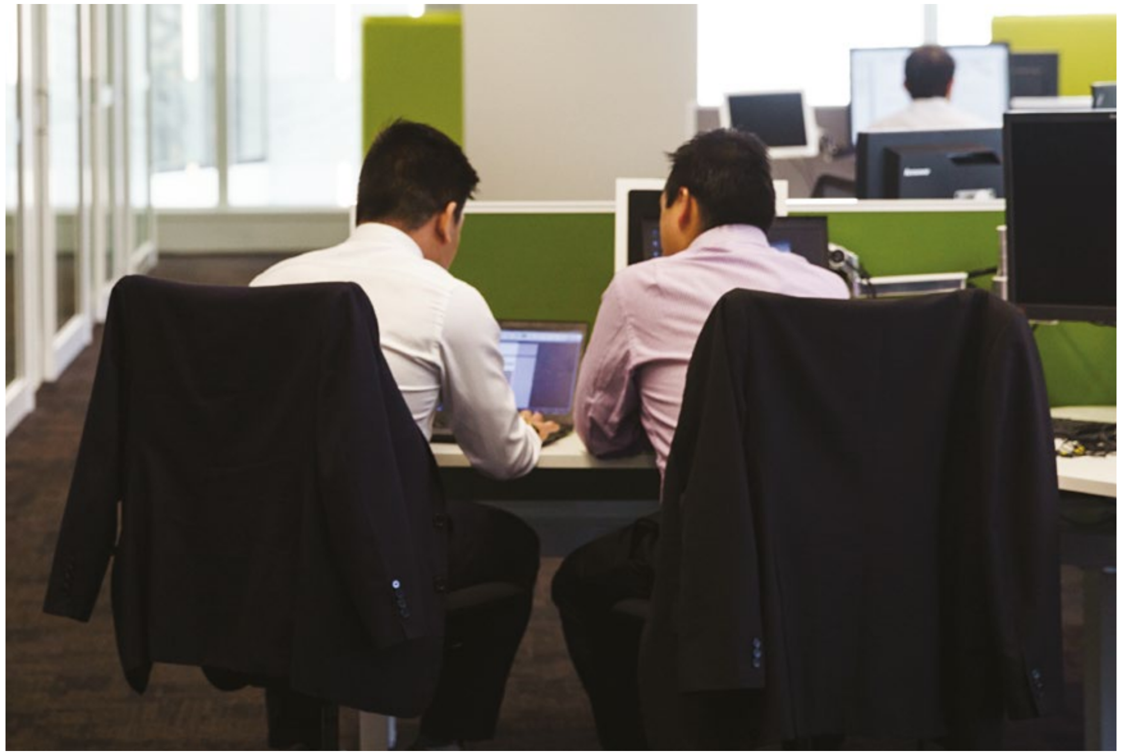
From a practical perspective, the new rules have resulted in a heightened focus on transfer pricing by corporate executives, boards, and tax managers alike. Key changes under the new rules, together with the practical implications and best practice compliance measures being adopted by Australian taxpayers include:

---

[1] Subdivisions 815-B, C and D of the Income Tax Assessment Act 1997.
[2] SNF (Australia) Pty Ltd v Commissioner of Taxation.

Taking the lead – Reform to Australia's transfer pricing landscape in a global context

- The new rules operate on a self-assessment basis, which has resulted in a requirement for taxpayers (or more specifically the Public Officer) to make an informed self-assessment of the company's transfer pricing compliance, together with disclosure in its income tax return regarding the extent of transfer pricing documentation maintained to support the arm's length nature of related party dealings.
- Transfer pricing documentation must be prepared prior to lodgement of the tax return if a taxpayer wants to be eligible to establish a reasonably arguable position (RAP) for penalty protection purposes. The heightened exposure to penalties under the new documentation requirements has resulted in MNEs undertaking a broader assessment, 'health check' and update of their existing transfer pricing policies and documentation (or preparation of additional documentation where insufficient documentation existed previously).
- Specific requirements in relation to the nature of transfer pricing documentation (together with self-assessment) have been legislated in Australia which diverges from existing OECD guidance. This has seen MNEs seeking to rely on global core/master file style documentation preparing additional analysis to bridge the gap from OECD compliant transfer pricing documentation to achieve compliance with Australia's laws.
- Reconstruction provisions have been introduced, which allow actual transactions to be disregarded and hypothetical arm's length transactions to be substituted in certain circumstances. This has resulted in analysis that goes beyond pricing, to substantiate the substance and overall commercial rationale of transfer pricing arrangements, to mitigate the risk of reconstruction. Notably, the legislative provisions have a lower threshold than the OECD guidelines which permit reconstruction in only 'exceptional circumstances'.



Taking the lead – Reform to Australia's transfer pricing landscape in a global context

Reform agenda

As the Australian Government leads the charge on implementation of tax and transfer pricing reform, a Bill has been introduced to Australian Parliament on 16 September 2015 containing a suite of proposed measures impacting MNEs operating in Australia.

1. OECD transparency measures

The Bill contains provisions incorporating the new OECD standards on transfer pricing documentation (master file and local file) and country by country reporting (CbCR). The proposed legislation will apply from 1 January 2016 to taxpayers with annual global group revenue exceeding A$1 billion.

It is expected that the disclosure requirements (not yet disclosed by the ATO at the time of writing) will closely follow the Action 13 guidance issued by the OECD. The practical implications of the draft law are:

- Australian headquartered multinational enterprises – will be required to lodge a CbC report in addition to both a Master File and Local File with the ATO.
- Australian subsidiaries of foreign headquartered multinational enterprises – will be required to lodge both a masterfile and local file with the ATO, unless granted an exemption by the ATO. No CbCR will be required in Australia if the ATO is able to obtain the CbCR from the tax authority in the local entity's parent entity jurisdiction.

Information disclosed to the ATO will be made available to other revenue authorities through mutual exchange procedures. Given the ATO is likely to be one of the first revenue authorities to obtain this information, it will be important that MNEs are prepared with robust, consistent and sufficiently detailed documentation covering their global arrangements.

The impending implementation of the OECD transfer pricing documentation and CbC reporting standards in Australia should also act as a catalyst for MNEs to consider both the mechanics of collating relevant information to meet these requirements, as well as the strategy for the organisation managing its tax 'profile' globally amongst its internal and external stakeholders in light of increased transparency.

Given the ATO is likely to be one of the first revenue authorities to obtain this information, it will be important that MNEs are prepared with robust, consistent and sufficiently detailed documentation covering their global arrangements.

Taking the lead – Reform to Australia's transfer pricing landscape in a global context

2. Increased penalties

The Bill contains measures to double the maximum administrative penalties for companies with global group revenues exceeding A$1 billion. This will apply where the taxpayer does not have a RAP and the ATO assessment relates to tax avoidance or transfer pricing. As noted above, taxpayers must have transfer pricing documentation on file at the time of lodging the income tax return to establish a RAP for transfer pricing matters, emphasising the importance of MNEs undertaking annual analysis and documentation of transfer pricing arrangements.

3. New General Anti Avoidance Rules and Goods and services tax reform

Targeted changes to the general anti avoidance rules (GAAR) were also included in the Bill, often referred to as Australia's version of the Diverted Profits Tax. These provisions operate as an override to any conflicting provisions in Australia's double taxation agreements and domestic source provisions to effectively deem an Australian permanent establishment (PE) in circumstances where there is a presence in Australia, and goods or services are sold by a related entity outside Australia to Australian customers. The rules are complex, subjective and contain a number of requirements which must all be collectively satisfied before the rules apply.

In addition to the measures in the Bill, another reform measure of relevance to MNEs which was announced by the Australian Government as part of its 2015/16 Federal Budget are amendments to apply the Australian goods and services tax (GST) to digital products and services imported by Australian consumers.

Whilst the above two reform measures were introduced with the primary intention of targeting companies operating in the digital space, as currently drafted the proposed reforms have the potential to inadvertently impact a range of MNEs providing products or services into Australia where there is no Australian physical presence. Accordingly, affected MNEs should consider how the proposed reforms may impact their Australian operations.

Public, political & ATO scrutiny

The environment of public and political scrutiny of the taxes paid by MNEs in Australia has continued to increase. This has been highlighted by the recent Senate Inquiry into corporate tax avoidance in which a number of key stakeholders were called for questioning, including companies operating in the mining, technology and pharmaceutical industries. Practically, consistent

Taking the lead – Reform to Australia's transfer pricing landscape in a global context

with similar inquiries in the UK and US, these public inquiries illustrate the importance of MNEs proactively developing stakeholder communication strategies in anticipation of increased public scrutiny of MNE tax affairs.

With this backdrop additional funding has been provided to the ATO to monitor taxpayer compliance. Whilst MNEs can expect the ATO to continue to focus its transfer pricing review and audit activities on traditional risk areas (e.g. business restructures, intercompany financing, loss making companies) this funding will see a continued expansion of compliance activity and interest in perceived BEPS mischief (e.g. digital economy, intangibles, PEs).

In view of this increasing uncertainty, the ATO has reinvented its advance pricing arrangement (APA) program

through the release of a new practice statement, PS LA 2015/4. This guidance effectively formalises changes the ATO started to introduce over the last 12 months, including:

- A front ended early engagement phase prior to taxpayers being accepted into the APA program, with a greater focus on identifying and appropriately considering collateral tax issues related to the matter covered by the APA (i.e. beyond transfer pricing).
- The requirement for greater internal ATO stakeholder involvement and approval from early engagement and at defined points throughout the process, (including internal workshops and assignment of a Competent Authority to each case).

The new guidance reinforces the ATO's commitment to the APA program and enables taxpayers to better understand the expectations of the ATO to assess the likelihood of their particular facts and circumstances being suited to the APA product.

Taking the lead – Reform to Australia's transfer pricing landscape in a global context

This represents an opportune time for taxpayers to assess their individual risk profile, in light of continued ATO review and audit activity, and to understand the potential benefits of seeking greater certainty through an APA.

Key takeaways

MNEs should consider the implications of the current Australian transfer pricing landscape to their specific circumstances, including:

- Determining whether sufficient analysis and documentation has been prepared in compliance with the new legislative regime to enable penalty protection.
- From a practical perspective, the new rules, together with the current political landscape in Australia have resulted in a heightened focus on transfer pricing by corporate executives, boards, and tax managers alike.
- The Australian Senate inquiry illustrates the importance of Australian taxpayers proactively developing stakeholder communication strategies in anticipation of increased public scrutiny of MNE tax affairs.
- It is an opportune time for taxpayers to assess their individual risk profile, in light of continued ATO review and audit activity, and to understand the potential benefits of seeking greater certainty through an APA.

Taking the lead – Reform to Australia's transfer pricing landscape in a global context

Authors

Jenny Elliott
PwC Australia
+61 3 8603 3753
jenny.elliott@au.pwc.com

Dritton Xhemajlaj
PwC Australia
+61 7 3257 5646
dritton.xhemajlaj@au.pwc.com

Hiral Mistry
PwC Australia
+61 2 8266 0683
hiral.mistry@au.pwc.com

Theoretical and practical challenges introduced by BEPS Action 4

Theoretical and practical challenges introduced by BEPS Action 4

The aim of Action 4 of the Organisation for Economic Co-operation and Development's (OECD) BEPS Action Plan is to produce coordinated and transparent rules to address base erosion and profit shifting through the use of interest expense.

The thin capitalisation and/or anti-avoidance tax rules enacted in an individual country's tax legislation, along with proposed hybrid mismatch rules, generally provide an appropriate balance between preventing tax base erosion through interest deductions and allowing the country to remain economically competitive. The aim of Action 4 of the Organisation for Economic Co-operation and Development's (OECD) BEPS Action Plan is to produce coordinated and transparent rules to address base erosion and profit shifting through the use of interest expense.
The OECD's final paper on Action 4: Interest Deductions and Other Financial Payments (the "Paper"), issued on 5 October 2015, sets out various options for addressing this issue.

Recommended approaches

The paper recommends limiting interest deductions primarily using an interest cover ratio, supplemented with a group wide ratio. These are explored in more detail below. A series of theoretical and practical questions will need to be addressed by governments and taxpayers alike in their compliance with the new recommendations.

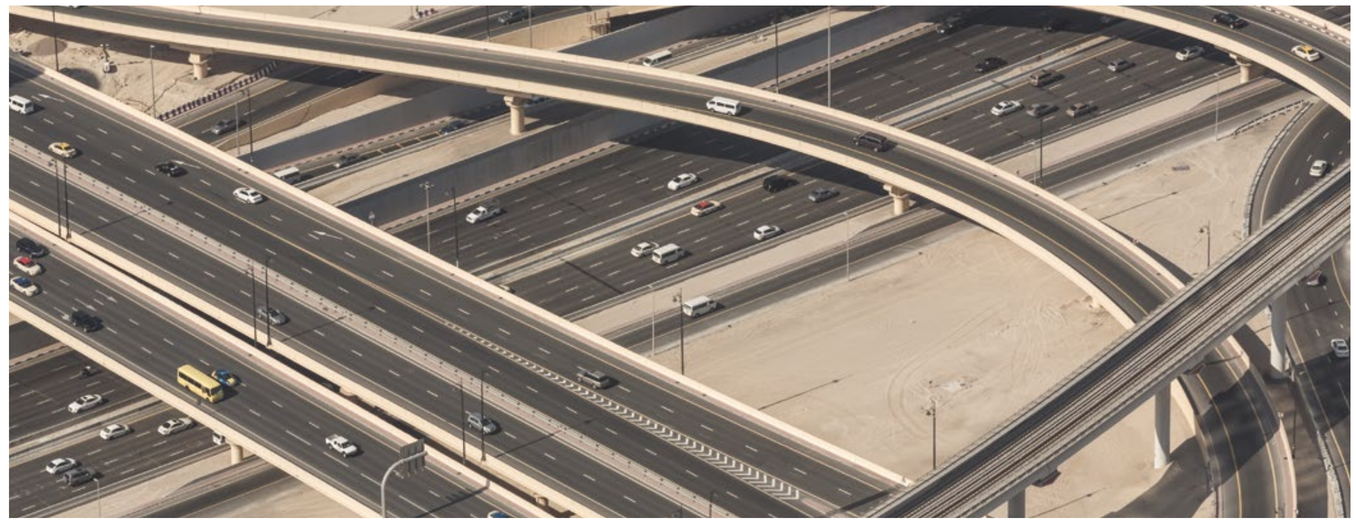
1. Fixed ratio test

A fixed ratio test would restrict net interest expense to a specified proportion of EBITDA (earning before interest, tax, depreciation and amortisation), assets or equity of a company. This type of approach is already widely used by a number of countries, for example the restriction of interest deductions based in Germany on the level of taxable EBITDA in Germany or based in the United States on the 'adjusted taxable income'. The Paper acknowledges,

Theoretical and practical challenges introduced by BEPS Action 4

however, the difficulty in setting an appropriate benchmark ratio that is low enough to address BEPS concerns without giving rise to significant double taxation risk.

The fixed ratio test will be the primary interest limitation rule, based on a "net interest/EBITDA" cap. The OECD recommends a threshold between 10% and 30%, indicating that countries will have some flexibility when adopting Action 4 in their local legislation. To manage volatility, disallowed interest or unused interest capacity could also be carried forward (or back). Countries may also choose to apply a fixed ratio on an average over a number of periods. There may also be a de minimis rule (e.g. interest remains fully deductible up to EUR 3 mil).



An artificially low fixed ratio would unfairly penalise capital-intensive industries such as infrastructure, which generally have higher debt ratios for non-tax reasons.

Issues

A fixed ratio test has the advantage of being relatively simple to apply and administer. In practice, fixed ratio tests appear to work well when countries are allowed to independently determine the nature and level of the ratio, as either a frontline test or anti-avoidance measure.

Countries may tailor fixed ratio tests according to industry; if a "one size fits all" fixed ratio test is applied, it would fail to account for differences in industries. For example, an artificially low fixed ratio would unfairly penalise capital-intensive industries such as infrastructure, which generally have higher debt ratios for non-tax reasons.

Public-Private Joint-ventures (PPS) funding would be out of scope. Banks and insurance companies would not fall under the rules, but may be subject to specific rules. In-house banks falling under Basel III rules would be considered as banks for the Action 4 rules.

Theoretical and practical challenges introduced by BEPS Action 4

However, there is no exclusion for treasury companies.

Regarding hedge fund/private equity structures, there still seems to be two conflicting positions: according to some such structures specific rules should be developed next year under the bank and insurance specific rules, while others argue they should fall under the general interest limitation rules.

These industry specific rules and considerations will be further developed in the course of 2016, however the likelihood is that certain industries may be significantly impacted if carve outs are not included within the fixed ratio test that allow for the nuances of the capital structures typically used in that sector.

2. Group-wide test

The recommended group-wide test outlined by the OECD in the paper is to allow interest deduction allowed up to the group's net interest/EBITDA ratio where this is higher than the fixed ratio.

Consensus is required under this approach. If not, double taxation or non-deductibility may result on actual net third party interest expense. For example, Company A acquires debt and allocates its interest expense across the group. Countries B, C and D have all adopted the group-wide test; however, Country B's tax laws do not allow for interest on the debt to be deducted as allocated. There would be a disproportionate allocation of interest expense for which a portion may not be deductible.

The group-wide test will be the secondary interest limitation rule (available as an option to the taxpayer if they do not pass the fixed ratio test). In an attempt to reduce the risk of a group-wide ratio rule not allowing a deduction for third party interest expense, territories are invited to allow this rule to give up to a 10% uplift on the group's net finance expense.

Further work will be carried out in 2016 by the OECD in relation the the implementation of the group-wide test.

Certain industries may be significantly impacted if carve outs are not included within the fixed ratio test that allow for the nuances of the capital structures typically used in that sector.

Theoretical and practical challenges introduced by BEPS Action 4

Issues

MNE's raise capital in the most cost efficient manner available. The introduction of a group-wide test has the potential to influence bona fide business decisions incentivising groups to take on more external debt than may be financially prudent.

The introduction of a group-wide test may also lead to MNE's taking a short-term view to broader business planning, as the ETR is likely to fluctuate more on an annual basis as interest deductions in each country will be unknown and difficult or impossible to forecast (as they will be a function of the economic activity of other group companies). This may impact economic factors such as medium and/or long term investment in labour and capital.

In addition, the proposed group-wide tests require a significant number of 'carve-outs' indicating that such a test would not be easier to apply and would not create an equitable result. For example, in addition to the requirement to have specific rules for industries such as banking and insurance, a group-wide test would presumably also need special rules for groups who are not debt funded such as private equity funds or pension funds.

Not allowing these companies to deduct interest expense may make these companies less competitive at a time when their investment can be significant in some countries. In addition, MNEs are often a portfolio of entities performing different functions, holding different assets, and bearing different risks. To apply the same framework and ratio to entities with these functional and risk-profile differences could result in different economic and tax outcomes on a legal entity basis.

Given the apparent complexity of the group-wide tests, their implementation will require taxpayers to allocate more resources (internal and external) than they currently allocate in order to apply the arm's length principle and local country thin cap legislation. MNE's will be required to apply the group-wide test annually, which at the very least will involve gathering significant amounts of financial data centrally and consolidating entities in countries where consolidated financial statements were not previously required.

Theoretical and practical challenges introduced by BEPS Action 4

Optional rules

A country may decide to apply other general interest limitation rules, such as the arm's length principle. It is suggested that in most cases that these rules should be applied before disallowing any additional amounts through the fixed ratio and group ratio rules.

The earnings-based worldwide group ratio rule can also be replaced by different group ratio rules, such as the "equity escape" rule (which compares an entity's level of equity and assets to those held by its group) currently in place in some countries.

In looking at the role of targeted rules, the paper identifies a number of scenarios that territories might choose to target, although it does not seem to address how these might deal with scenarios where groups are introducing debt into territories to allocate their finance expense in accordance with a group ratio rule, however local "motive" or "purpose" based tests apply.

Further challenges

Consistency across jurisdictions

Attempts at achieving consistency across jurisdictions will be very difficult since there are fundamentally different tax and accounting rules in each territory in terms of interest deductibility, and, as acknowledged in the Paper, there will continue to be specific additional interest limitations which will not be applied consistently.

In addition, there will undoubtedly be territories which do not adopt the proposals. One of the other uncertainties is the extent to which individual territories would replace existing interest restriction rules with these proposals. If countries decide to implement these rules, they are expected to give a reasonable transitional period or apply transitional rules with excludes interest on certain existing loans from the scope of the rules.

Definition of interest and other financial payments economically equivalent to interest

Difficulties arise in relation to the inclusion of foreign exchange amounts of entities in a group of territories which only tax foreign exchange on a realised basis, or where specific tax hedging rules apply which could create mismatches between amounts included in accounts and tax.

Similar issues could arise in relation to the inclusion of the finance cost element of finance lease payments where lease classification varies depending on the generally accepted accounting principles (GAAP). If an entity is in a territory that classifies a lease as an operating lease under local accounting and therefore tax rules, this could give a different answer

Theoretical and practical challenges introduced by BEPS Action 4

to a situation where the group accounts classify the lease as a finance lease.

As a general matter, the broader the category of financial payments that are included within the cap, the greater the number of variations that are likely to arise both between GAAP and tax, and across different jurisdictions.

Practical examples

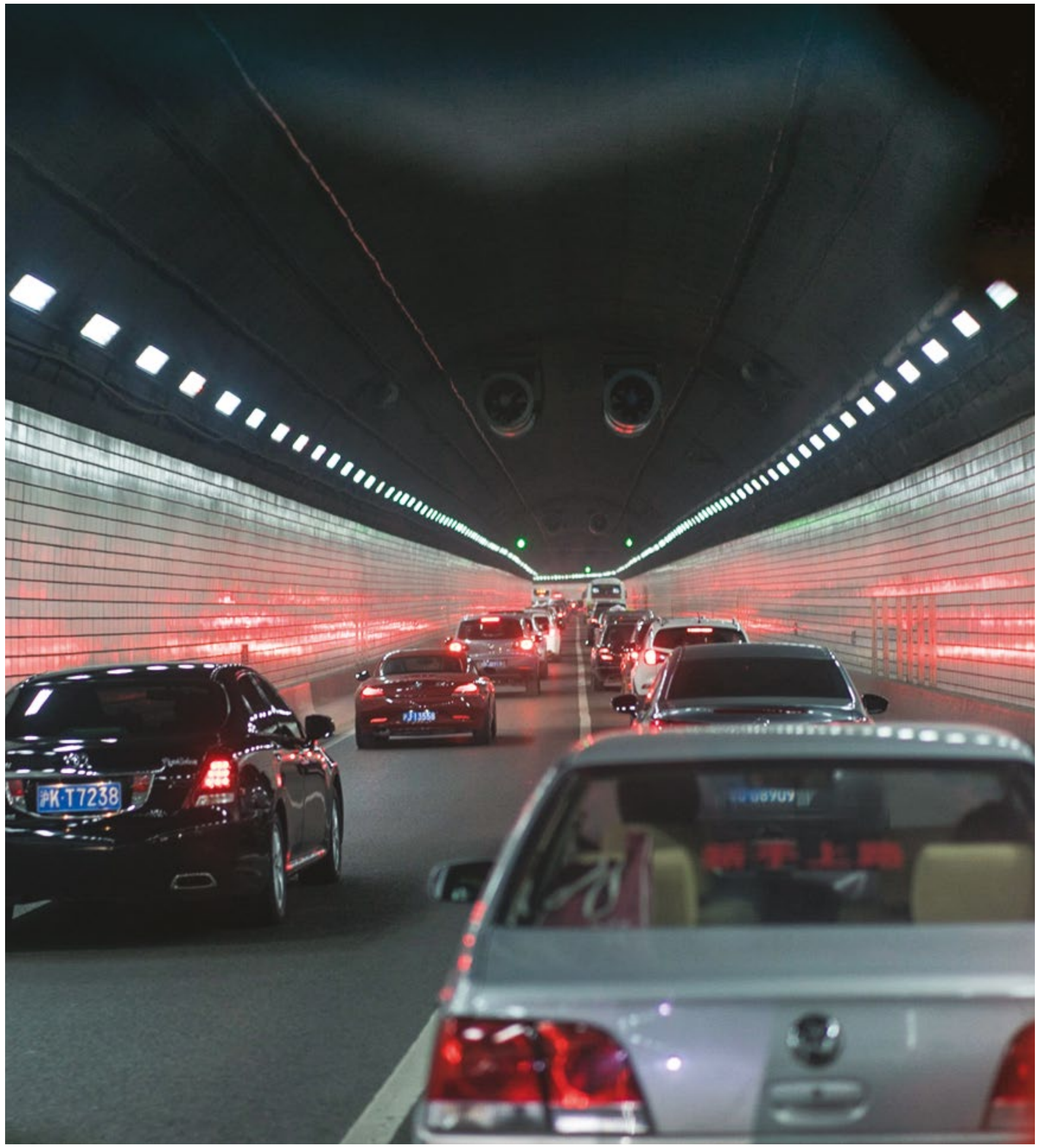
Taking the above theoretical issues one step further, there are practical issues associated with the use of fixed ratio or group-wide tests in replacement of an arm's length assessment.

Taking the above theoretical issues one step further, there are practical issues associated with the use of fixed ratio or group-wide tests in replacement of an arm's length assessment.

Examples of these practical issues are provided below:

Example 1 – Fixed ratio test

Let's take the example of a limited risk distributor operating within a multinational group. The limited risk distributor may be receiving an operating margin of say 2-3% per annum, but on a potentially large sales base. Assume that, after applying the fixed ratio test the chosen ratio was EBITDA/ interest, the limited risk distributor would have reasonable capacity to accommodate interest costs based on its fairly stable EBITDA profile. In contrast, a principal company that sells via the limited risk distributor may only have capacity for limited interest costs as its initial EBITDA is lower, even though it has numerous assets



Theoretical and practical challenges introduced by BEPS Action 4

and intellectual property, and is expected to grow over a 5-year period based on its functions and assets (all of which would have been taken into account in an arm's length analysis as they would form aspects that a third party lender would have considered).

Example 2 – Group-wide test

If we consider an alternative example whereby a group company is looking to make a significant investment in some new intellectual property or investment asset. The group company would be limited in its ability to debt fund that transaction by the specified group-wide debt ratio, even though this does not reflect one of the key elements that a third party lender would take into account (e.g. the asset value). In addition, the group-wide test is an annual test, so any debt used to fund the transaction may need to be repaid/capitalised if the group-wide ratios change annually. This leads to additional questions as to how to create debt instruments which have a varying debt quantum each year, and how such instruments should be priced.

Conclusion

The recommendations proposed as a result of BEPS Action 4 will have a fundamental impact on internal capital structures, compliance, investment decisions and overseas expansion for multinational groups. A further consideration to the points outlined above is that these propositions need to be reviewed in light of other BEPS Actions, such as the actions addressing hybrid mismatches, treaty anti-abuse, and controlled foreign companies, as they will play a part in preventing base erosion through the deduction of interest and other financial payments in inappropriate circumstances.

The recommendations in Action 4 will be supplemented over 2016 with guidance on the detailed operation of the worldwide group ratio rule and specific rules to address risks posed by banking and insurance groups. Further work on the transfer pricing aspects of financial transactions will be completed over 2016 and 2017.

Theoretical and practical challenges introduced by BEPS Action 4

Authors

Krishnan Chandrasekhar
PwC US
+1 312 298 2567
krishnan.chandrasekhar@us.pwc.com

Daniel Pybus
PwC UK
+44 20 7213 1359
daniel.j.pybus@uk.pwc.com

Jeff Rogers
PwC Canada
+1 416 815 5271
jeff.rogers@ca.pwc.com

Susan Vincent
PwC UK
+ 44 20 7212 5220
susan.vincent@uk.pwc.com

US perspectives on key transfer pricing aspects of the OECD BEPS project

US perspectives on key transfer pricing aspects of the OECD BEPS project

As the initial stage of the Organisation for Economic Co-operation and Development (OECD) Base erosion and profit shifting (BEPS) project draws to a close, the OECD has generated a greater volume of discussion and guidance in the project's time frame than many had thought possible. Focusing on three of the BEPS Actions with broad implications in the transfer pricing sphere, Actions 8, 9, and 10 and the final deliverables as well as the discussion drafts and commentary generated by OECD Working Party 6, we examine how the resulting changes to Chapters I, II, VI and VIII of the Transfer Pricing Guidelines present potential conflict with US tax law, including the transfer pricing regulations. We will explore these potential conflicts and their implications for both inbound and outbound US clients.

The earlier Actions 8, 9 and 10 discussion drafts featured elements that gave rise to significant concerns among taxpayers and practitioners, particularly in the areas of hard-to-value intangibles and risk and recharacterisation. The final deliverable of Working Party 6 reflects a view that in many ways addresses the commentary received on prior drafts and aligns with the goal of adhering to the arm's length principle under the Transfer Pricing Guidelines.

While some of these changes narrow what originally was a significant gulf between OECD guidance and domestic transfer pricing rules in many jurisdictions, several areas remain where companies will face the challenge of coping with differences between local authority and OECD guidance. In particular, companies operating in the US appear likely to face these challenges in the areas of potential recharacterisation of transactions, returns to risk and capital, and attempting to reconcile US Cost Sharing Arrangements with Cost Contribution Arrangements.

We will explore these potential conflicts and their implications for both inbound and outbound US clients.

US perspectives on key transfer pricing aspects of the OECD BEPS project

Risk and recharacterisation

In line with announcements during the OECD's 6 – 7 July 2015 public consultation on BEPS Actions 8 through 10, the final guidance scales back from the provisions around risk and recharacterisation of transactions that were contained in the December 2014 discussion draft on Chapter I of the OECD Guidelines. Those original drafts indicated a movement away from the arm's length principle and presented an easier path to tax authorities' recharacterisation of a company's arrangements, giving rise to extensive commentary. Key changes in the final guidance include the narrowing of the circumstances in which a transaction might be recharacterised, the moving away from the concept of "moral hazard", and the establishment of a six-step analytical framework for the treatment of risk.

The December 2014 draft's discussion around recharacterisation (also termed non-recognition) of a transaction or allocation of risk focused on transactions that take place between related parties and whether their 'fundamental economic attributes' are the same as those between unrelated parties. The final guidance focuses instead on the 'recognition of the accurately delineated transaction'. This takes into account contractual arrangements as the foundational basis for analysis. From this base, the approach turns to functional analysis and confirming the actual behaviour of the parties, then pricing in line with assumption of risks and functions performed. Much focus is placed on identification of the party bearing a particular risk, and the guidance looks both to financial capacity to assume a risk and functional exercise of control, acknowledging that more than one party may participate in controlling a risk and respecting contractual allocations of risk if the party with contractual allocation functionally participates in control of that risk. Recharacterisation is reserved for limited circumstances where the transaction does not reflect the 'commercial rationality of that which would be agreed between unrelated parties' and does not turn on whether a transaction is actually observed between unrelated parties.

US tax law does not permit recharacterisation unless the economic substance of a transaction differs from its structure, largely similar to the updated OECD guidance. Determinations of which party bears a particular risk under US tax law, which is broadly similar to that contained in the final guidance on Actions 8, 9 and 10, is often highly contentious on audit. To what degree different tax authorities' views of the 'accurately delineated transaction' will align, and whether companies will find themselves facing

US perspectives on key transfer pricing aspects of the OECD BEPS project

competing positions from multiple jurisdictions with each concluding a different 'reality' remains to be seen. However, given the current environment these provisions seem poised to engender controversy in the MAP environment and increase pressure on the output of Action 14, including mandatory binding arbitration.

Cost sharing and cost contribution arrangements

Cost sharing arrangements (CSAs) under the US transfer pricing regulations and OECD cost contribution arrangements (CCAs) have always been very different concepts, but the final guidance on CCAs illustrates additional conflict. A CSA requires upfront contributions to be compensated at an arm's length price, but ongoing contributions of cash or intangible development activities are measured and aligned with expected benefits at cost. It is this alignment of risks borne with anticipated benefit that places participants on equal footing from a risk and reward standpoint, and consequently no royalties or other payments are required for intangibles created within the CSA. Under the CCA guidance contributions to a CCA are to be tied to value when determining the respective contributions of the parties throughout the life of the arrangement. This includes consideration of opportunity cost for contributions and only allows for measurement of current contributions based on cost in limited circumstances where costs generate proportionate value across all contribution types and some return to capital to an entity contributing pure funding to the arrangement. Further, the guidance specifies that identification of participants in a CCA includes a requirement that a participant exercise control over and have financial capacity to bear the risks assumed under the CCA, again leading to a focus on functions performed.

These differing approaches to sharing risks and benefits of development activity present significant potential for inconsistency across jurisdictions, a result that is squarely at odds with the stated objectives of the BEPS project overall. CSAs and CCAs are thus expected to be an additional area of pressure in the dispute resolution setting as tax authorities begin to apply these principles in practice.

Returns to capital

Another area of disparate treatment under OECD and US guidance is the treatment of cash-rich entities with no or only nominal people functions, i.e., 'cash boxes'.

US tax law has no restrictions on cash box entities enjoying certain benefits allowed by the US code and regulations. For example, in an outbound intellectual property (IP) transfer subject to US IRC §367(d), there are no functional requirements placed on the

US perspectives on key transfer pricing aspects of the OECD BEPS project

recipient of the IP. Similarly, the operation of the US cost sharing regulations place no requirements on the functionality of cost sharing participants, so long as an arm's length price is paid for platform contributions and cost sharing payments are made in line with expected benefits.

As expected based on the OECD's July 2015 public consultation, the OECD rules are designed to entitle a cash box entity to no more than a risk-free return for its contributions of capital in intercompany arrangements.

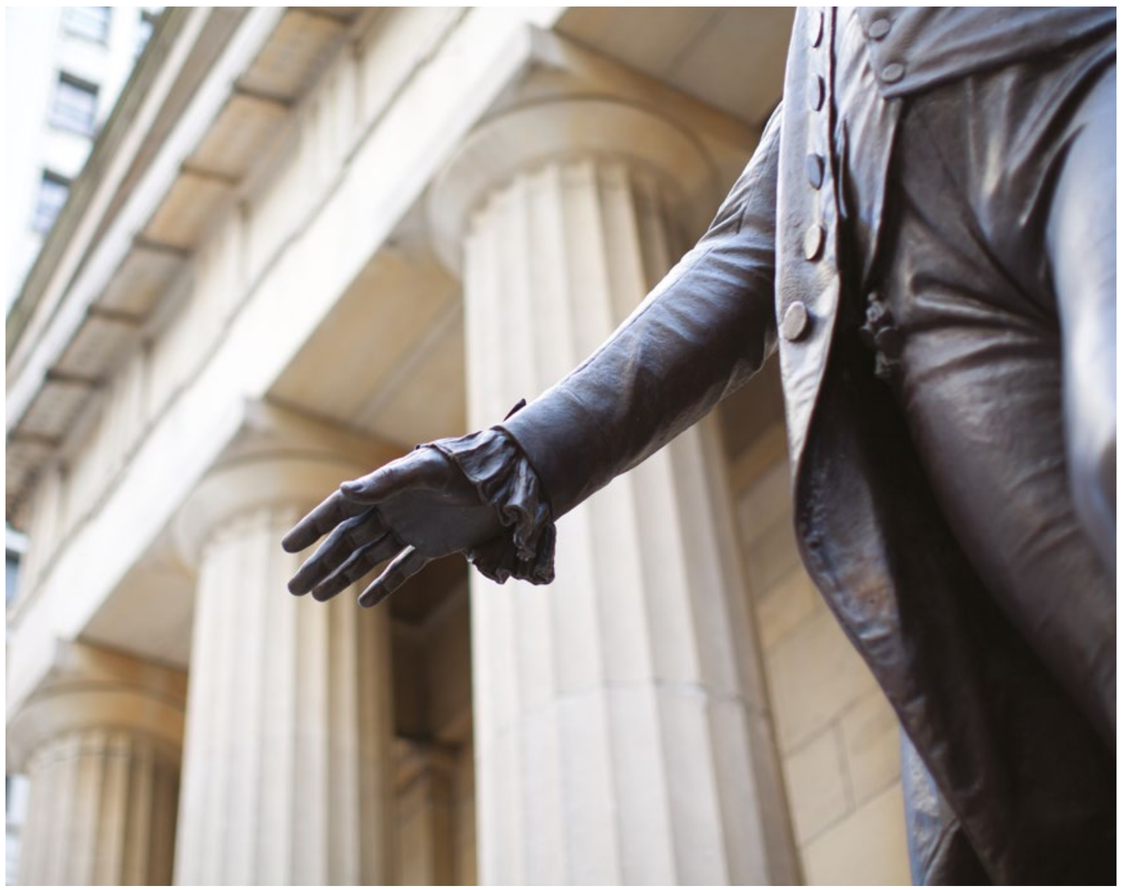
Overall, the treatment of cash boxes under the BEPS project looks for a higher level of substance and functionality and the guidance is largely geared towards ensuring that cash box entities no longer are entitled to residual or premium returns. As these entities are a primary focus of the BEPS project and of many tax authorities, the scrutiny placed on them will be

As expected based on the OECD's July 2015 public consultation, the OECD rules are designed to entitle a cash box entity to no more than a risk-free return for its contributions of capital in intercompany arrangements.

intense and enhanced by the rhetoric that is a recurring feature of the current international tax landscape.

Finally, it was recognized by the OECD that the financial services industry is unique in terms of the role played by risk and capital, and as the guidance on Actions 8, 9, and 10 is not specific to one industry it allows for consideration of prior industry specific guidance. As financial services regulators move towards an expectation of people functions in their jurisdiction, these distinctions may harmonise somewhat, but the question of what type of activity and authority is

US perspectives on key transfer pricing aspects of the OECD BEPS project



Accordingly, regardless of the degree of consistency or inconsistency between US tax law and OECD guidance, as a defensive measure, clients should be prepared to view related party transactions from multiple perspectives and consider the resulting outcomes.

necessary to enjoy certain returns will almost certainly remain. Said another way, the reward for capital at risk may be recognised in a more traditional manner without financial services companies being burdened by the broader risk and recharacterisation principles relevant in other sections of the Transfer Pricing Guidelines.

Planning for uncertainty

In advance of the October 2015 G20 Finance Ministers meeting, the BEPS project has reached its initial stage of completion. The specific impact on the OECD Transfer Pricing Guidelines and tax enforcement globally is foreseeable with more specificity, but the true impact on clients is only beginning. Implementation of OECD guidance at the local jurisdiction level, or implementation of unilateral measures (whether aligned or in conflict with that guidance) will set the stage for tax planning, compliance, and controversy to come.

For companies operating in the US, with measures now adopted by OECD which are in conflict with certain elements of US tax law, we anticipate that clients will face significant increased potential double taxation with no clear path to conceptual resolution.

Additionally, if the US tax auditors perceive that non-US audits will heavily impact CFCs' profits available for repatriation, they may take increasingly aggressive US positions on audit, including increased refusal to accept additional tax assessments as creditable taxes in the US.

Accordingly, regardless of the degree of consistency or inconsistency between US tax law and OECD guidance, as a defensive measure, clients should be prepared to view related party transactions from multiple perspectives and consider the resulting outcomes.

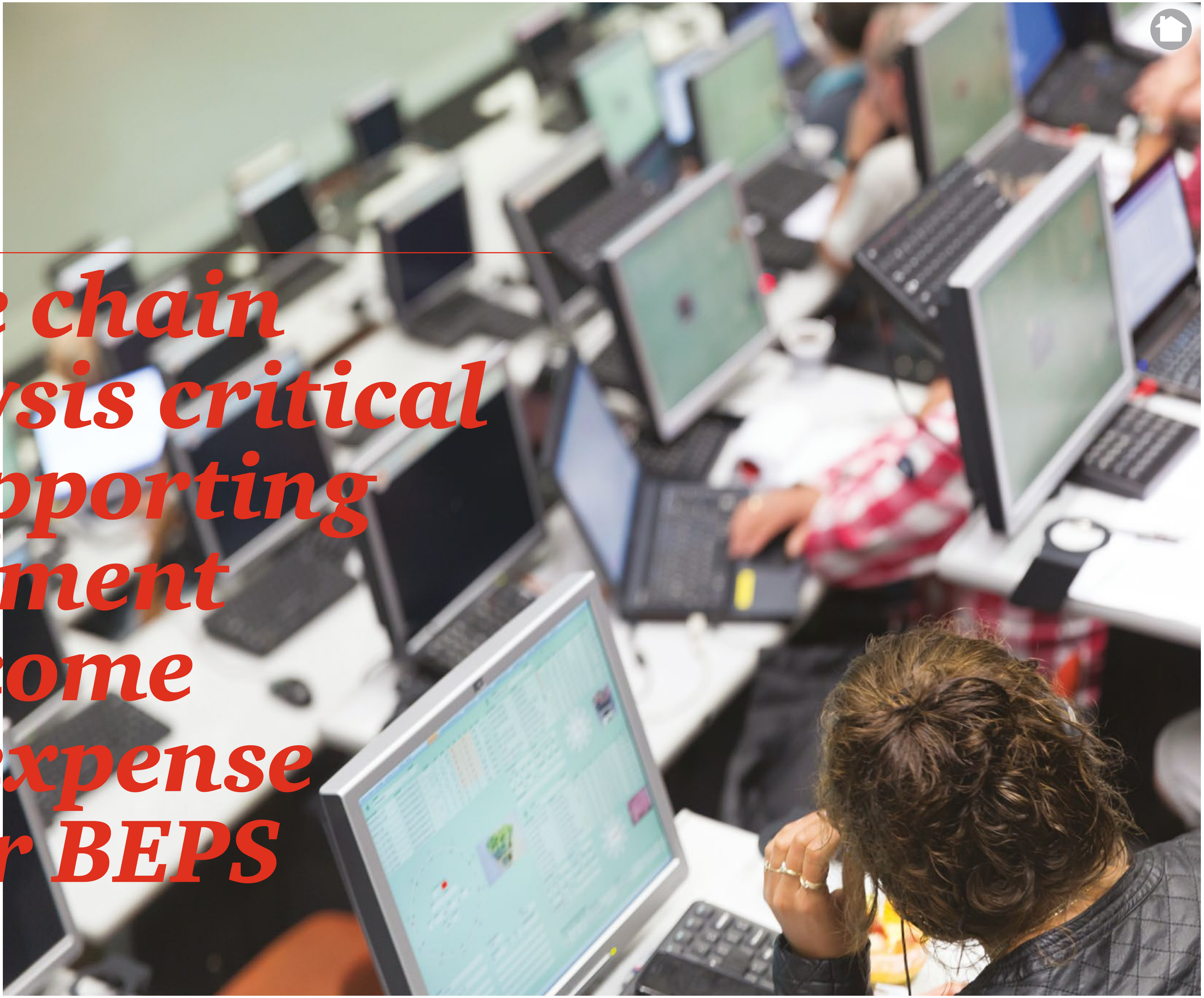
US perspectives on key transfer pricing aspects of the OECD BEPS project

Authors

Adam Katz
PwC US
+1 646 471 3215
adam.katz@us.pwc.com

Kathryn Horton O'Brien
PwC US
+1 202 414 4402
kathryn.horton.obrien@us.pwc.com

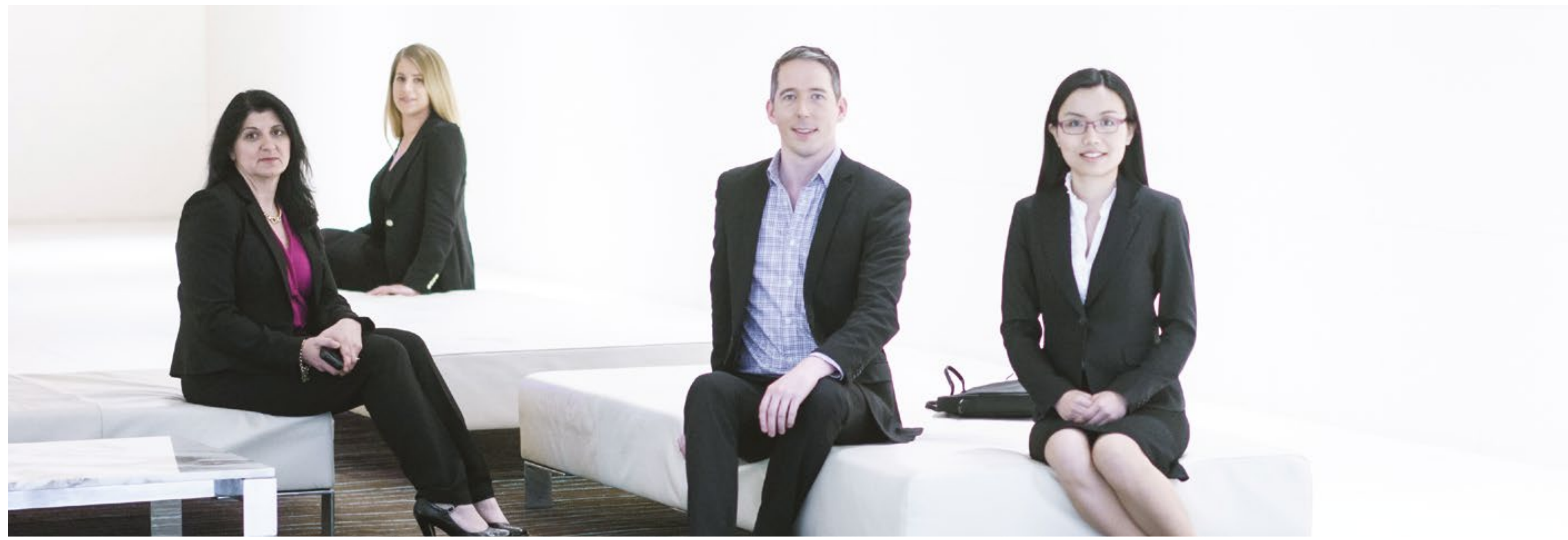
Natalie Hodapp
PwC US
+1 646 471 1835
natalie.v.hodapp@us.pwc.com



Value chain analysis critical in supporting alignment of income and expense under BEPS

Value chain analysis critical in supporting alignment of income and expense under BEPS

To successfully develop, implement, and defend intercompany pricing policies and results in the post-BEPS environment, MNEs should consider an holistic approach to transfer pricing analysis...



Increasingly, multinational enterprises (MNEs) rely on complex, integrated global supply chains to deliver products, services, and solutions to their customers worldwide. As a result, MNEs must appropriately allocate income and expense across their organisations to reflect the contributions of value made by local operations in line with relevant transfer pricing rules. Numerous factors complicate this exercise for MNEs, including the continuous evolution of local country operations, limitations in established transfer pricing methodologies for analysing multifaceted cross-border relationships, and the increasing demand for transparency and detailed reporting of intra-group transactions announced under the OECD's Base Erosion and Profit Shifting (BEPS) initiative.

To successfully develop, implement, and defend intercompany pricing policies and results in the post-BEPS environment, MNEs should consider an holistic approach to transfer pricing analysis that focusses on the fundamental contributors of value – in terms of functions performed, assets employed, and risks borne – along the integrated supply chain and that evaluates the value created at both micro and macro levels. Robust value chain analysis (VCA) is a must for MNEs with highly integrated supply chains in the current global tax policy climate.

Value chain analysis critical in supporting alignment of income and expense under BEPS

BEPS and the value chain

Introduced in July 2013, the BEPS Action Plan represents an attempt by the OECD to tackle the perceived misallocation of income and expense among various jurisdictions arising out of differences in international tax laws between countries that result in double non-taxation (i.e., income that is not taxed in any country) as well as instances where profits are perceived as geographically divorced from the activities that gave rise to that income. Transfer pricing – the discipline of pricing intercompany transactions – is at the core of many of the areas the BEPS initiative aims to address.

In total, 44 countries – including the OECD's member states, the members of the G20, Latvia and Colombia – have been involved in the negotiation and drafting of the BEPS deliverables. Although perceived by many in the tax community to be an aggressive timeline, the OECD has largely met the initial time frame – which included a goal of having all work streams complete by December 2015 – for its deliverables.

Fundamentally, BEPS is focused on transparency and the alignment of profit and expense – and, therefore, income tax paid – with value-creating activity. Although visible across the range of work streams, these themes are particularly apparent in Action 8 (Transfer Pricing Aspects of Intangibles), Action 9 (Risks and Capital), and Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting).

BEPS Action 8 focuses on the alignment of transfer pricing outcomes with respect to intangibles with value-creation activities. For MNEs, the question of how intangibles contribute to value creation in a highly integrated supply chain is critical. More and more, MNEs rely upon non-legally protectable intangibles – such as systems, processes, procedures, checklists, and other valuable know-how. Consequently, traditional methods of valuation and income attribution to intangibles may not yield the most accurate results. To manage potential challenges from tax authorities, MNEs must clearly articulate and document their analysis of the traditional and non-traditional intangibles employed in their supply chains and demonstrate the value added and the parties responsible for the creation of that value.

Transfer pricing – the discipline of pricing intercompany transactions – is at the core of many of the areas the BEPS initiative aims to address.

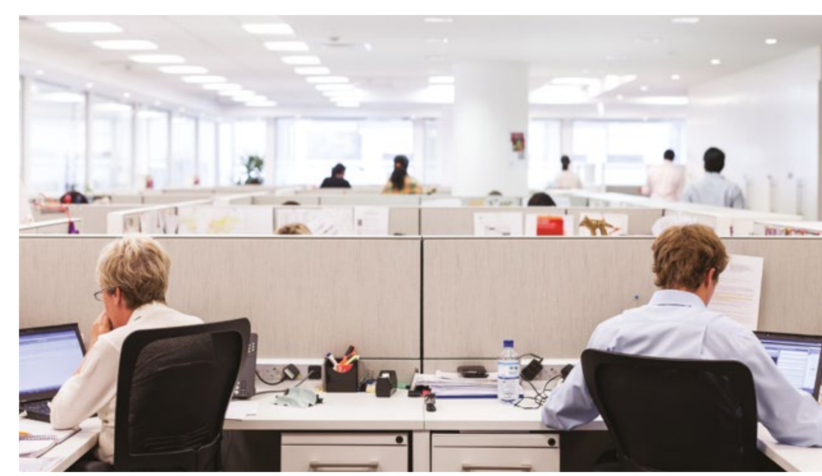
Value chain analysis critical in supporting alignment of income and expense under BEPS

Action 9 is designed to develop rules to prevent base erosion and profit shifting through the transfer of risks among – or the allocation of excessive capital to – members of an MNE. Essentially, the issue is one of determining the appropriate reward for the parties assuming risk and contributing capital which may be dissociated from the parties with the human capital performing day-to-day operational activities. For organisations with highly integrated supply chains, there may be dozens of local, routine operators executing an array of activities, but which do not bear 'real economic risk' in the performance of functions. The OECD's approach under BEPS appears to start from the assumption that if risk is shared among members of an MNE, at least in the first instance, the starting proposition should always be the established relevant legal agreements.

Although held out as a tool, albeit one that must be employed cautiously, recharacterisation of the functional profiles of MNE members by tax authorities will likely prove to be problematic in practice as government examiners grapple with the interrelated and interdependent activities within MNEs that create value in the market. Accordingly, the best defence against recharacterisation is expected to be a clear expression of value creation grounded in intuitive analysis using market based data.

The BEPS Action 13 deliverable, introduced by the OECD on 16 September 2014, has a three-tiered approach to transfer pricing documentation. As part of the recommended transfer pricing documentation package, the guidance directs an MNE to develop a master file – providing an all-inclusive view of its global business dealings and operations. In particular, the master file calls for the MNE to provide a general written description of its global business including the important drivers of business profit; a description of the supply chain for the MNE's five largest product or service offerings (or both), as well as any other offerings that constitute more than 5% of

The best defense against recharacterisation is expected to be a clear expression of value creation grounded in intuitive analysis using market based data.



Value chain analysis critical in supporting alignment of income and expense under BEPS

global turnover and a written analysis describing the principal contributions to value creation by individual entities within the MNE interpreted to mean the functions performed, assets (both tangible and intangible employed), and risks borne by each party. Action 13 heightens the need for innovative and deeper types of value creation analysis to meet these documentation requirements and thereby uses the master file as a proactive recharacterisation risk-mitigation tool.

A new methodology for ascribing value creation

VCA provides a unique approach for leveraging data and analytics to evaluate an MNE's overall value chain and profit profile, rather than a simpler method of evaluating whether or not specific transactions adhere to the historically applied arm's length standard. To undertake this analysis, VCA draws on significant amounts of detailed, publicly available data which typically has been excluded from traditional transfer pricing analyses.

Specifically, VCA has the unique ability to synthesise and simultaneously consider an MNE's own corporate data and the way in which similarly situated enterprises describe the risks or value drivers in their businesses. Bringing these information sets together allows an MNE to form an overall conclusion by reference not only to its own activities and structure, but also in the context of its competitors and the broader industry and macroeconomic environment in which it operates.

Although most transfer pricing analysis is performed at the local level, VCA takes the group level as its starting point. Thus, the data used in VCA generally allows for the evaluation of the value associated with specific types and categories of activity, referred to as 'competencies.' VCA first focuses on values or relative values that can be identified and then maps them into the value chain.

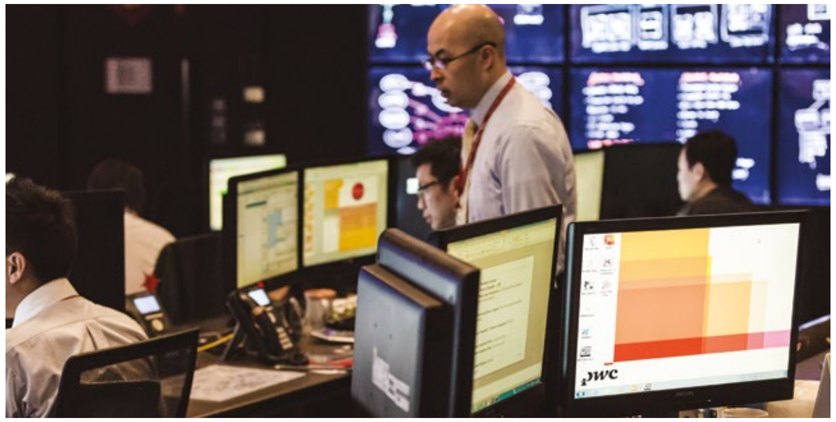
In terms of employing this distinctive methodology, an MNE typically would leverage VCA to identify a 'normal' profitability level for its industry. In this context, it is important not to confuse this prevailing rate of profit with the conventional transfer pricing notion of a 'routine return,' as the companies being analysed in this step will likely have non-routine levels of profit, intangibles, and risk. Next, the MNE would analyse other enterprises – often competitors – whose profit levels are above or below the identified expected rate. This approach will

Although most transfer pricing analysis is performed at the local level, VCA takes the group level as its starting point.

Value chain analysis critical in supporting alignment of income and expense under BEPS

usually permit relatively objective observations as to which competencies are value enhancing, value eroding, or simply absent – as well as the relative contributions of each. Contrasting the competencies exhibited by companies generating normal profits against those whose profits significantly deviate from the predominant rate may help MNEs to focus on competitive advantages and key differentiating value drivers, such as intangibles and assumption of risk.

Applying VCA has the added benefit of eliminating subjective weightings of the contribution of individuals or decisions, an approach for which there remains a substantial lack of consensus among tax authorities and practitioners. At the same time, it is important that VCA is not conflated with a profit split approach. It is likely that VCA may support a viewpoint that the activities in a given territory are appropriately remunerated under the OECD's established transactional net margin method.



Looking to the future

Elementally, VCA provides a sophisticated synthesis of an MNE's global value chain in a manner more akin to the approach business leaders and senior executives take toward strategy development and execution than historical tax-based techniques. In particular, VCA aligns with key BEPS themes around transparency and reporting of value creation within global organisations while also allowing companies to consider and present the impact of intangibles – both legally protected and not – and risk on value creation within the overall business rather than as a static reference fixed to the existing legal entity framework.

As every MNE has its own unique characteristics and culture – and the available information in the public domain applicable to each industry differs – VCA is dynamic, providing a disciplined and systematic approach while remaining flexible, adaptable, and evolutionary. Although BEPS has spurred significant change in the global tax policy and administrative landscape, MNEs can take advantage of opportunities to mitigate enterprise risk proactively, and drive greater value for their stakeholders, by embracing VCA to evaluate, analyse, and articulate the way in which value is created – and rewarded – across their complex, integrated supply chains.

A version of this article originally appeared in Tax Notes Int'l, September 28, 2015, p. 1121.

Value chain analysis critical in supporting alignment of income and expense under BEPS

Authors

Ian Dykes
PwC UK
+44 121 265 5968
ian.dykes@uk.pwc.com

Tim Holmes
PwC Denmark
+45 3945 3830
timothy.holmes@dk.pwc.com

Liz Sweigart
PwC US
+1 713 356 4344
elizabeth.a.sweigart@us.pwc.com

Value Chain Analysis – Preventive care for radical transparency

Value Chain Analysis – Preventive care for radical transparency

Today, the "wait and see" strategy of how to deal with imminent transparency of your transfer pricing positions is no longer an option and having a well-crystalised action plan is by now well overdue.

The OECD Base Erosion and Profit Shifting (BEPS) project is dramatically changing the transfer pricing landscape for pharmaceuticals and life sciences (PLS) multinationals. It would come as a surprise if you did not already have strategic discussions on how to address the new challenges triggered by the additional disclosure requirements and the enhanced transparency of your global value chain and system profitability, as required by the new country by country requirements. It is also safe to assume these developments are high on your agenda given the complex supply chains, intense M&A activity, and the dynamic intellectual property arrangements that are so prevalent in this industry. Today, the "wait and see" strategy of how to deal with imminent transparency of your transfer pricing positions is no longer an option and having a well-crystalised action plan is by now well overdue.

Have you already defined your value drivers and how various supply chain participants contribute to value creation? If not yet comfortable with a final conclusion, you might want to consider a new practical approach to value chain analysis (VCA).

A new world of transparency and disclosure

Transparency is at the forefront of today's transfer pricing reality. The new set of disclosure requirements introduced by the OECD is inarguably changing the landscape of transparency. It is now more critical than ever to review your company's value drivers and profit allocations across the value chain, as well as your overall transfer pricing positions. PLS companies should be particularly planning for this new world of transparency given the complexity of industry supply chains and intellectual property arrangements, as well as the commercially sensitive information

Value Chain Analysis – Preventive care for radical transparency

steaming from their business model. Given the high profile of the industry, it is also noteworthy to mention that increased transparency has been called for by several stakeholders other than the tax authorities: the public, health regulators, the media, politicians and non-governmental organisations. A recent example are the Senate hearings in Australia where nine PLS multinationals have been asked to become more transparent with respect to their tax planning strategies and the share of Australian profit in global profits.

In light of the new master file, local file and country by country requirements, PLS companies have to be prepared to fully disclose their value chain and how the allocation of global profits to the various supply chain participants reflects value creation. Experience shows that this is a fairly strategic task that requires not only deep insights into the company's business model, core competences and competitive advantages, but also the monitoring of industry developments that often impact the thinking around value drivers and value creation across geographies. In this view, one cannot omit to consider aspects such as patent expirations and how they can reshape value drivers for a drug or other aspects such as effective supply chain management or successful post-deal integration. As a result of M&A activity, many PLS companies rush to harmonise their transfer pricing policies, and often fail to properly review and reconcile website information and other public information sources that may preserve evidence of divergent transfer pricing positions.

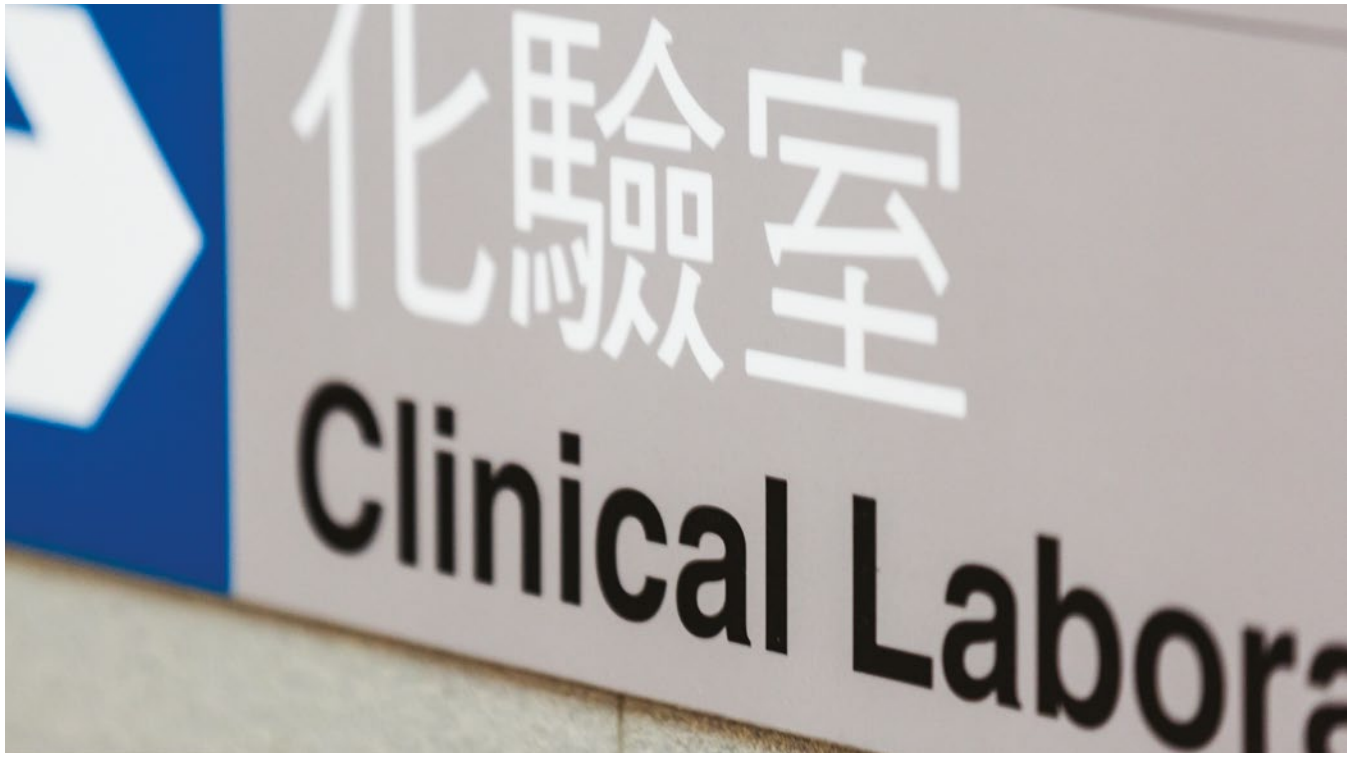
Nowadays, any discussion on transfer pricing transparency inevitably brings into the spotlight the country by country reporting requirements.

Nowadays, any discussion on transfer pricing transparency inevitably brings into the spotlight the country by country reporting requirements. More and more countries are swiftly adopting the OECD guidance on these new compliance requirements into their domestic law. Spain is one of the

Value Chain Analysis – Preventive care for radical transparency

latest examples where country by country reporting requirements will apply for tax periods starting 1 January 2016. In addition to the costs and complexity associated with country by country reporting compliance, PLS companies also have to consider the challenges associated with disclosing information that may be commercially sensitive. While the country by country reporting information is meant to stay confidential and only shared for the tax authorities' review, a key implementation threat is the potential accidental disclosure of such information to the public or business competitors. For the PLS industry, any leak of information may be particularly costly as it has the potential to reveal key aspects underpinning the company's business strategy and focus areas.

Needless to say that the country by country reporting template must tell a story that is closely aligned with the discussion of value drivers and global profit allocation presented in the master file. It therefore becomes imperative to clarify and articulate your transfer pricing strategy and tell a consistent story that is supported both by facts, financials and other empirical evidence. In terms of consistency under the new disclosure rules, one can expect that tax authorities will also be looking for any indication of inconsistent treatment of similar transactions either geographically or across lines of business. If any harmonization of TP policies or housekeeping is required to help manage disclosure risks, it is recommended to carry out this exercise before the new disclosure rules start to apply.



Needless to say that the country by country reporting template must tell a story that is closely aligned with the discussion of value drivers and global profit allocation presented in the master file.

Value Chain Analysis – Preventive care for radical transparency

Compliance in the BEPS world no longer means simply complying with minimal documentation requirements. BEPS compliance now means anticipating and addressing the following six imminent risks and threats:

These new compliance attributes are particularly relevant for PLS multinationals that have traditionally been the most targeted companies when it comes to transfer pricing challenges.

Traditional TP documentation often presented the industry analysis and the supply chain as narrative descriptions that did little more than add context to the TP analysis. The more holistic questions that arise now are what other data is out there and how it can be best used.

Value chain analysis – stepping outside traditional boundaries

Fast paced changes most often require taking a step back to rethink traditional approaches and explore new avenues to meet the new disclosure requirements. What if you did not only rely on your company's functional analysis and your own internal assessment of value drivers? What if your analysis also relied on external public information that is less subjective and more difficult to challenge in an audit? Step outside the boundaries of internal value chain analysis and broaden your perspective with a deeper understanding of business competencies specific to the PLS industry and how they map to value creation and allocation of profits to various supply chain participants.

Traditional TP documentation often presented the industry analysis and the supply chain as narrative descriptions that did little more than add context to the TP analysis. The more holistic questions that arise now are what other data is out there and how it can be best used.

Value Chain Analysis – Preventive care for radical transparency

Welcome our new suggested approach to value chain analysis (VCA).

In brief, VCA is an innovative and practical approach that can help PLS multinationals respond to the new transparency requirements while using publicly available data. It is a holistic process that looks at the whole value chain rather than individual entities and therefore, addresses all of the evolving concerns presented above. By engaging in a business competency based analysis, one also embraces a broader perspective than only looking at people based functions. This attribute of the VCA helps manage the latest strong bias towards disregarding the role of capital and risk in favour of people functions. It is also an analysis that may address some preconceptions or questions such as: are local distributors creating marketing intangibles if all market players incur similar levels of advertising & promotional spend? Or is this a cost of doing business in the industry rather than a spend that secures PLS companies a competitive advantage or a monopolistic market situation?

The ultimate objective of VCA is to stress test your transfer pricing positions and allocation of global system profit, to confirm that the outcomes of your transfer pricing policy reflect value creation by each value chain participant and to identify any exposure areas that may represent the scope of controversy in audits. The VCA will result in a mapping of the profits associated with various business competencies against the PLS company's unique operating model by looking at the relevant activities and applying empirical data to associate contributions with profit. This has proved to be a very powerful tool for documentation, risk mitigation and audit defence purposes that is based on objective and irrefutable external data that complements and supports existing internal analysis and also provides a strong platform for presenting the results of the TP analysis under the new disclosure rules.

VCA in the PLS industry – let's get started

The first step of VCA is to carry out a peer group analysis. The key objective of this analysis is to identify a set of relevant PLS peers for your company, review their financials and pinpoint differences between peers in an attempt to spot attributes or business competencies that translate into value drivers and increased profitability.

The set of peers may vary depending on the nature of the business and the product portfolio, but often the differences between sets of peers provide the most useful evidence of which attributes are adding value. For example, peers may be grouped based on generics versus innovative products, focus on Human Health

In brief, VCA is an innovative and practical approach that can help PLS multinationals respond to the new transparency requirements while using publicly available data.

Value Chain Analysis – Preventive care for radical transparency

vs Animal Health vs Consumer Healthcare products and other aspects that define similarity with other PLS market players.

The next step is defining the attributes or business competencies that are observed to give rise to differences in profitability. This requires an in-depth understanding of the industry and its dynamics,[1] as well as an appreciation of what business competencies represent value drivers and are therefore indicative of value creation. This is definitely not a standard analysis and will be unique to the specifics of every business. It is a thoughtful and strategic exercise that will help measure value creation and link it to various competencies that are later mapped to functions, risks and assets of the supply chain participants. One particular characteristic of the VCA is that it can be iterative as it is performed in stages and therefore refined as it progresses.

Once the results of the VCA analysis are available, the puzzle may fit neatly into place and you have a robust analysis based on proven external data to support your transfer pricing positions and allocation of profits within the value chain.

Peer Group Analysis – Pharma Industry

Source: As reported Bureau Van Dijk Database, July 2015.

[1] Comprehensive new intelligence, perspectives, and analysis on trends affecting all health-related industries can be found on the web page of the PwC Health Research Institute (http://www.pwc.com/us/en/health-industries/health-research-institute/index.jhtml)

Value Chain Analysis – Preventive care for radical transparency

One immediate question is: what to do if some results are divergent with your current transfer pricing policies? This could be an indication that there are some aspects of your transfer pricing strategy that have to be revisited to proactively manage audit exposure and time consuming discussions with respect to your country by country reporting template. It may also merely be an indication that there is a notable difference between your business model and that of your peers that leads to some divergence in value drivers and how various supply chain participants contribute to value creation. It may also be the VCA needs to be refined or it may be necessary to look at other risk areas such as permanent establishment or substance. Either way, it is definitely better to identify these divergence areas as soon as possible and prior to an audit. Performing the VCA in the early stage of defining your BEPS action plan has multiple benefits ranging from introducing new procedures to manage risk to better managing the enhanced disclosure requirements.

Five signs you should consider the VCA analysis as part of your BEPS readiness assessment:

1. You have not yet finalized your master file approach to presenting your value chain, value drivers and value creating activities undertaken by the various supply chain participants
2. Your draft country by country reporting template reflects some divergence between the allocation of global system profit and the location of value creating functions
3. You are still working to articulate what are the value drivers of your business and what business attributes do not generate a competitive advantage, nor have the potential to create intangible assets
4. Your assessment of the company's value drivers is mainly based on internal data without closely considering PLS industry developments and how other PLS market players define their success
5. You have concerns about managing transfer pricing audits in the BEPS environment and how you can defend your company against challenges related to industry hot topics such as local marketing intangibles or harmonization of transfer pricing positions subsequent to M&A activity

Value Chain Analysis – Preventive care for radical transparency

Companies who have embraced this new approach, going beyond the boundaries of traditional transfer pricing analysis, are able to feel confident about having a robust defence to sustain their transfer pricing positions or are able to identify any exposure areas that need to be promptly addressed before they become visible in their master file and country by country reporting.

Conclusion

If you are still getting ready to portray your value chain X-ray in the new world of transparency, the VCA analysis can have a significant value add in clarifying and crystallising your strategy to manage the new disclosure requirements. Companies who have embraced this new approach, going beyond the boundaries of traditional transfer pricing analysis, are able to feel confident about having a robust defence to sustain their transfer pricing positions or are able to identify any exposure areas that need to be promptly addressed before they become visible in their master file and country by country reporting.

Value Chain Analysis – Preventive care for radical transparency

Authors

Horacio Peña
PwC US
+1 646 471 1957
horacio.pena@us.pwc.com

Brian Burt
PwC US
+1 646 471 8386
brian.t.burt@us.pwc.com

Blanca Kovari
PwC US
+1 646 471 6817
blanca.v.kovari@us.pwc.com

A truly global Transfer Pricing network

With over 3,105 dedicated professionals in over 90 countries, PwC's leading transfer pricing network is well positioned to advise you on a strategy that can help advance your goals within the ever-shifting compliance landscape.

Global Leader	**Isabel Verlinden**	**+32 2 710 4422**	isabel.verlinden@be.pwc.com
Argentina	Juan Carlos Ferreiro	+54 11 4850 6712	juan.carlos.ferreiro@ar.pwc.com
Australia	Pete Calleja	+61 2 8266 8837	pete.calleja@au.pwc.com
Austria	Herbert Greinecker	+43 1 501 883 300	herbert.greinecker@at.pwc.com
Azerbaijan	Movlan Pashayev	+994 12 497 2515	movlan.pashayev@az.pwc.com
Bahrain	Mohamed Serokh	+971 4 304 3956	mohamed.serokh@ae.pwc.com
Belgium	Patrick Boone	+32 2 710 4366	patrick.boone@be.pwc.com
Brazil	Cristina Medeiros	+55 11 3674 3818	cristina.medeiros@br.pwc.com
Bulgaria	Irina Tsvetkova	+359 2 935 5126	irina.tsvetkova@bg.pwc.com
Cameroon, Republic of	Nadine Tinen	+237 3 343 2443	nadine.tinen@cm.pwc.com
Canada	Gordon R. Jans	+1 416 815 5198	gordon.r.jans@ca.pwc.com
Chile	Roberto Carlos Rivas	+56 2 940 0000	roberto.rivas@cl.pwc.com
China	Jeff Yuan	+86 21 2323 3495	jeff.yuan@cn.pwc.com
Colombia	Carlos Mario Lafaurie	+57 1 634 0555 (ext 404/327)	carlos_mario.lafaurie@co.pwc.com
Congo, Dem Republic of	Léon Nzimbi	+243 81 037 2645	leon.nzimbi@cd.pwc.com
Congo, Republic of	Emmanuel Le Bras	+242 06 658 3636	emmanuel.lebras@cg.pwc.com
Costa Rica	Ramon Ortega	+1 809 567 7741	ramon.ortega@do.pwc.com
Croatia	Lana Brlek	+3861 583 6058	lana.brlek@hr.pwc.com
Czech Republic	David Borkovec	+420 2 5115 2561	david.borkovec@cz.pwc.com
Denmark	Thomas Bjerre	+45 3 945 3824	tab@pwc.dk
Dominican Republic	Ramon Ortega	+1 809 567 7741	ramon.ortega@do.pwc.com

Our transfer pricing territory contacts

Ecuador	Pablo Aguirre	+593 2 382 9350 (ext 361)	pablo.aguirre@ec.pwc.com
Egypt	Abdallah Eladly	+20 2 2759 7700 (ext 7887)	abdallah.eladly@eg.pwc.com
El Salvador	Ramon Ortega	+1 809 567 7741	ramon.ortega@do.pwc.com
Equatorial Guinea	Sébastien Lechêne	+240 33 309 1434	sebastien.lechene@ga.pwc.com
Estonia	Hannes Lentsius	+372 614 1800	hannes.lentsius@ee.pwc.comt
Finland	Sari Takalo	+358 9 2280 1262	sari.takalo@fi.pwc.com
France	Pierre Escaut	+33 1 5657 4295	pierre.escaut@fr.landwellglobal.com
Georgia	Robin McCone	+995 32 250 8050	robin.mccone@ge.pwc.com
Germany	Lorenz Bernhardt	+49 30 2636 5204	lorenz.bernhardt@de.pwc.com
Greece	Agis Moschovakos	+30 210 687 4544	agis.moschovakos@gr.pwc.com
Guatemala	Ramon Ortega	+1 809 567 7741	ramon.ortega@do.pwc.com
Hong Kong	Cecilia SK Lee	+852 2289 5690	cecilia.sk.lee@hk.pwc.com
Hungary	Anita Mekler	+36 1 461 9372	anita.mekler@hu.pwc.com
Iceland	Jon I. Ingibergsson	+354 550 5342	jon.i.ingibergsson@is.pwc.com
India	Sanjay Tolia	+91 22 6689 1322	sanjay.tolia@in.pwc.com
Indonesia	Ay Tjhing Phan	+62 21 5289 0658	ay.tjhing.phan@id.pwc.com
Iraq	Mohamed Serokh	+971 4 304 3956	mohamed.serokh@ae.pwc.com
Ireland	Gavan Ryle	+353 1 792 8704	gavan.ryle@ie.pwc.com
Israel	Vered Kirshner	+972 3 795 4849	vered.kirshner@il.pwc.com
Italy	Gianni Colucci	+39 02 9160 5500	gianni.colucci@it.pwc.com
Japan	Daisuke Miyajima	+81 3 5251 2552	daisuke.miyajima@jp.pwc.com
Jordan	Mohamed Serokh	+971 4 304 3956	mohamed.serokh@ae.pwc.com

Our transfer pricing territory contacts

Kazakhstan, Republic of	Richard Bregonje	+7 727 330 3200	richard.bregonje@kz.pwc.com
Kenya	Titus Mukora	+254 20 285 5395	titus.mukora@ke.pwc.com
Korea, Republic of	Henry An	+82 2 3781 2594	henry.an@kr.pwc.com
Kuwait	Mohamed Serokh	+971 4 304 3956	mohamed.serokh@ae.pwc.com
Latvia	Pavel Sarghi	+40 21 225 3250	pavel.x.sarghi@lv.pwc.com
Lebanon	Mohamed Serokh	+971 4 304 3956	mohamed.serokh@ae.pwc.com
Libya	Mohamed Serokh	+971 4 304 3956	mohamed.serokh@ae.pwc.com
Lithuania	Nerijus Nedzinskas	+370 5 239 2350	nerijus.nedzinskas@lt.pwc.com
Luxembourg	Loek de Preter	+352 494 848 2023	loek.de.preter@lu.pwc.com
Malaysia	Jagdev Singh	+60 3 2173 1469	jagdev.singh@my.pwc.com
Mexico	Fred Barrett	+52 55 5263 6069	fred.barrett@mx.pwc.com
Moldova	Ionut Simion	+40 21 225 3702	ionut.simion@ro.pwc.com
Mongolia	Tsendmaa Choijamts	+976 70 009 089	tsendmaa.choijamts@mn.pwc.com
The Netherlands	Gaby Bes	+31 88 792 4144	gaby.bes@nl.pwc.com
New Zealand	Erin Venter	+64 9 355 8862	erin.l.venter@nz.pwc.com
Nigeria	Seun Adu	+234 9 291 9302	seun.y.adu@ng.pwc.com
Norway	Morten Beck	+47 9 526 0650	morten.beck@no.pwc.com
Oman, The Sultanate of	Mohamed Serokh	+971 4 304 3956	mohamed.serokh@ae.pwc.com
Palestinian Territories	Mohamed Serokh	+971 4 304 3956	mohamed.serokh@ae.pwc.com
Perú	Miguel Puga	+51 1 211 6500 (ext 8006)	miguel.puga@pe.pwc.com
Philippines	Carlos T. Carado	+63 2 459 2020	carlos.t.carado@ph.pwc.com
Poland	Piotr Wiewiorka	+48 22 523 4645	piotr.wiewiorka@pl.pwc.com

Our transfer pricing territory contacts

Portugal	Jaime Esteves	+351 21 359 9212	jaime.esteves@pt.pwc.com
Qatar	Mohamed Serokh	+971 4 304 3956	mohamed.serokh@ae.pwc.com
Romania	Ionut Simion	+40 21 225 3702	ionut.simion@ro.pwc.com
Russian Federation	Andrey Kolchin	+7 495 967 6197	andrey.kolchin@ru.pwc.com
Kingdom of Saudi Arabia	Mohamed Serokh	+971 4 304 3956	mohamed.serokh@ae.pwc.com
Singapore	Nicole Fung	+65 6236 3618	nicole.fung@sg.pwc.com
Slovak Republic	Christiana Serugová	+421 2 5935 0614	christiana.serugova@sk.pwc.com
Slovenia	Lana Brlek	+38 61 583 6058	lana.brlek@hr.pwc.com
South Africa	David Lermer	+27 21 529 2364	david.lermer@za.pwc.com
Spain	Javier González Carcedo	+34 91 568 4542	javier.gonzalez.carcedo@es.landwellglobal.com
Sri Lanka	Hiranthi C Ratnayake	+94 11 471 9838	hiranthi.c.ratnayake@lk.pwc.com
Sweden	Pär Magnus Wiséen	+46 10 213 3295	paer.magnus.wiseen@se.pwc.com
Switzerland	Benjamin Koch	+41 58 792 4334	benjamin.koch@ch.pwc.com
Taiwan	Lily Hsu	+886 2 2729 6207	lily.hsu@tw.pwc.com
Tanzania	David Tarimo	+255 22 219 2600	david.tarimo@tz.pwc.com
Thailand	Peerapat Poshyanonda	+66 2 344 1220	peerapat.poshyanonda@th.pwc.com
Turkey	Ozlem Guc Alioglu	+90 212 326 6462	ozlem.guc@tr.pwc.com
Uganda	Francis Kamulegeya	+256 41 423 6018	francis.kamulegeya@ug.pwc.com
Ukraine	Olga Trifonova	+380 444 906 777	olga.trifonova@ua.pwc.com
United Arab Emirates	Mohamed Serokh	+971 4 304 3956	mohamed.serokh@ae.pwc.com
United Kingdom	Annie Devoy	+44 20 7212 5572	annie.e.devoy@uk.pwc.com
United States	Horacio Pena	+1 646 471 1957	horacio.pena@us.pwc.com

Our transfer pricing territory contacts

Uruguay	Daniel Garcia	+598 2 916 0463	garcia.daniel@uy.pwc.com
Republic of Uzbekistan	Jamshid Juraev	+998 71 120 6101	jamshid.juraev@uz.pwc.com
Venezuela	Elys Aray	+58 212 700 6627	elys.aray@ve.pwc.com
Vietnam	Van Dinh Thi Quynh	+84 4 3946 2246 (ext 1500)	dinh.quynh.van@vn.pwc.com
Zambia	George Chitwa	+260 21 1256471	george.chitwa@zm.pwc.com

Want to keep up to date with the latest developments?

Click here for our transfer pricing newsalerts

Download *TP to Go* from your app store

Visit our dedicated BEPS website

www.pwc.com/transferpricing

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with more than 208,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

Design Services 29257 (10/15).