Operational Transfer Pricing

Webinar on Transfer Pricing
Contact information
Get in contact!

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Agenda

1. A glimpse into the transfer pricing life cycle
2. Focus on transfer pricing process and controlling
3. Example on how to gather data and prepare a proper process for transfer pricing calculation
4. Technology-based transfer pricing process
5. A look on how to prepare for transfer pricing adjustments and COVID-19
Transfer pricing life cycle

The starting point!

- Tax Strategy
- TP Planning
- Operational Transfer Pricing
- TP Compliance

IC agreements
- Process and controlling
- Business review / transaction analysis
- Economic analysis calculation
- Comparability analysis / benchmark
- Audit defence
Transfer pricing process and controlling

The time is now!

Operational transfer pricing is about ensuring an accurate, transparent and efficient implementation of transfer pricing policies in the books and records of a company based on quality data and robust processes and controls.

Data
- Tax sensitised data with necessary data dimensions, suitably validated.
- Ability to easily incorporate and manipulate disparate data sources.

Processes
- Strong audit trail with clear responsibilities across functions.
- Clear and timely monitoring and adjustment processes.

People
- Correct skills set (tax, finance, IT) for now and the future.
- Clear alignment on objectives.

Technology
- All blocks supported by appropriate technology solutions tailored to fit within, and complement, every businesses’ IT environment, strategy and roadmap.
- Automating manual, repetitive and low value-added tasks.
Transfer pricing process and controlling

Typical challenges and pain points

You need to understand the GL account/cost centre structure, including guidance for booking, to ask the relevant questions:

• What costs and revenue are booked in the GL accounts relevant for intercompany?
• Are the bookings (revenue and costs) only relevant for intercompany purposes?

Important areas to discover

• Can we identify the intercompany revenue and related costs and perform an economic analysis for the transfer pricing documentation?
• Can we align the data between recipient and provider and how do we tackle bulk-adjustments for elimination purposes?
• How should we book year-end adjustments, and can it be done in the country?

Indonesia
“The Indonesian TP regulations do not provide specific guidance on year-end adjustments. Based on our experience, the DGT tends to scrutinise such adjustments with great detail and seek for supporting documents in respect of such adjustments, especially downward adjustment (e.g. whether intercompany agreement contains such provisions, background, etc.)”

Malaysia
“In Malaysia, while there is no specific prohibition on true-up/down, the following need to be noted:

1. Ideally, all YEA should flow through the books (on-the-books), since the return must be prepared based on audited financial statements. Off-the-books downward adjustment to taxable profit is generally disallowed in audit.
2. Agreement must provide for such YEA.
3. The IRBM generally scrutinises year-end downward book adjustments more from perspective of characterisation of the local entity, clause in the intercompany permitting such adjustments and year-beginning price setting process to achieve desired arm’s length results”.
It all starts with data…

Example of calculating a service fee

Can the service income be aligned with the service cost at the recipient?

Can we allocate the expenses to the services provided?

Are all relevant salaries for the services provided booked at the right GL account?

Can we divide the salaries on the functions performed?

Data gathering - GL account details

<table>
<thead>
<tr>
<th>Number</th>
<th>Description</th>
<th>Value (DKK)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-001</td>
<td>Cash</td>
<td>1,573,000</td>
</tr>
<tr>
<td>1-002</td>
<td>Account receivable</td>
<td>4,500,005</td>
</tr>
<tr>
<td>1-003</td>
<td>Current assets</td>
<td>1,450,777</td>
</tr>
<tr>
<td>1-004</td>
<td>Fixed assets</td>
<td>450,746</td>
</tr>
<tr>
<td>1-005</td>
<td>Equity</td>
<td>388,642</td>
</tr>
<tr>
<td>1-006</td>
<td>Payables</td>
<td>4,876,097</td>
</tr>
<tr>
<td>1-007</td>
<td>Loans</td>
<td>2,709,789</td>
</tr>
<tr>
<td>4-001</td>
<td>External revenue</td>
<td>250,973</td>
</tr>
<tr>
<td>4-002</td>
<td>Internal revenue</td>
<td>10,988,150</td>
</tr>
<tr>
<td>4-003</td>
<td>Advertising expenses</td>
<td>756,937</td>
</tr>
<tr>
<td>4-004</td>
<td>Renting</td>
<td>1,514,940</td>
</tr>
<tr>
<td>4-005</td>
<td>Social benefits</td>
<td>987,789</td>
</tr>
<tr>
<td>4-006</td>
<td>Salaries</td>
<td>22,284,518</td>
</tr>
<tr>
<td>4-007</td>
<td>Supplies expenses</td>
<td>874,000</td>
</tr>
<tr>
<td>4-008</td>
<td>Depreciation</td>
<td>489,879</td>
</tr>
<tr>
<td>4-009</td>
<td>Other expenses</td>
<td>1,937,009</td>
</tr>
</tbody>
</table>

Data analysis - Determining the cost base

<table>
<thead>
<tr>
<th>Total costs</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overhead</td>
<td>5,803,617</td>
</tr>
<tr>
<td>Salaries</td>
<td>22,284,518</td>
</tr>
</tbody>
</table>
... and then processes must ensure that the data is used properly

Example of calculating a service fee

Data analysis - Splitting the cost base to functions

<table>
<thead>
<tr>
<th>Function</th>
<th>Salaries</th>
<th>Overhead</th>
<th>Total</th>
<th>In scope?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direction</td>
<td>862,705</td>
<td>224,676</td>
<td>1,087,381</td>
<td>Exclude</td>
</tr>
<tr>
<td>Finance</td>
<td>3,837,476</td>
<td>999,404</td>
<td>4,836,880</td>
<td>Include</td>
</tr>
<tr>
<td>Human Resources</td>
<td>6,498,083</td>
<td>1,692,313</td>
<td>8,190,395</td>
<td>Include</td>
</tr>
<tr>
<td>Information</td>
<td>9,371,290</td>
<td>2,440,590</td>
<td>11,811,880</td>
<td>Exclude</td>
</tr>
<tr>
<td>IT Services</td>
<td>1,090,438</td>
<td>283,986</td>
<td>1,374,423</td>
<td>Include</td>
</tr>
<tr>
<td>Legal</td>
<td>13,771</td>
<td>3,587</td>
<td>17,358</td>
<td>Include</td>
</tr>
<tr>
<td>Marketing</td>
<td>610,755</td>
<td>159,061</td>
<td>769,815</td>
<td>Include</td>
</tr>
</tbody>
</table>

Remember the benefit test of the recipient

Data analysis - Allocate the proper costs per recipient

<table>
<thead>
<tr>
<th>Function</th>
<th>Total Cost Pool</th>
<th>SH Cost</th>
<th>Total charge-out</th>
<th>Allocation Key</th>
<th>Company Y</th>
<th>Company Z</th>
<th>Company YZ</th>
<th>Company ZZ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Finance</td>
<td>4,836,880</td>
<td>35%</td>
<td>3,143,972</td>
<td>Revenue total</td>
<td>2,428,853</td>
<td>208,137</td>
<td>277,924</td>
<td>214,839</td>
</tr>
<tr>
<td>Human Resources</td>
<td>8,190,395</td>
<td>35%</td>
<td>5,323,757</td>
<td>Headcount</td>
<td>3,443,394</td>
<td>688,679</td>
<td>530,013</td>
<td>273,446</td>
</tr>
<tr>
<td>IT Services</td>
<td>1,374,423</td>
<td>50%</td>
<td>687,212</td>
<td>Revenue total</td>
<td>530,901</td>
<td>45,495</td>
<td>60,749</td>
<td>46,960</td>
</tr>
<tr>
<td>Legal</td>
<td>17,358</td>
<td>50%</td>
<td>8,679</td>
<td>Revenue total</td>
<td>6,705</td>
<td>575</td>
<td>767</td>
<td>593</td>
</tr>
<tr>
<td>Marketing</td>
<td>769,815</td>
<td>35%</td>
<td>500,380</td>
<td>Revenue external</td>
<td>414,849</td>
<td>-</td>
<td>48,240</td>
<td>37,290</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7,761,008</strong></td>
<td></td>
<td><strong>1,023,120</strong></td>
<td></td>
<td><strong>1,024,830</strong></td>
<td><strong>655,948</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Transfer pricing analysis - Calculate the transfer pricing

<table>
<thead>
<tr>
<th></th>
<th>Company Y</th>
<th>Company Z</th>
<th>Company YZ</th>
<th>Company ZZ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total costs</td>
<td>7,761,008</td>
<td>1,023,120</td>
<td>1,024,830</td>
<td>655,948</td>
</tr>
<tr>
<td>Mark-up</td>
<td>388,050</td>
<td>51,156</td>
<td>51,241</td>
<td>32,797</td>
</tr>
<tr>
<td><strong>Service fee</strong></td>
<td><strong>8,149,058</strong></td>
<td><strong>1,074,276</strong></td>
<td><strong>1,076,071</strong></td>
<td><strong>688,745</strong></td>
</tr>
</tbody>
</table>
Finally, the data must be presented in the transfer pricing documentation
Example of how an arm’s length analysis is presented for a service fee

The typical transfer pricing documentation

<table>
<thead>
<tr>
<th>Transaction value</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Service provider</td>
<td>Service recipient</td>
<td>Amount (DKK)</td>
<td>TP method</td>
</tr>
<tr>
<td>Company X</td>
<td>Company Y</td>
<td>8,149,058</td>
<td>TNMM NCP</td>
</tr>
</tbody>
</table>

Transfer pricing analysis

The pricing policy of 5% was used for the intercompany transaction.

In accordance with Section 6(4) of Danish Executive Order no. 42 of 24 January 2006, no search for similar service arrangements among unrelated parties intended to document the arm’s length nature of the transaction has been performed.

Based on the above and thanks to the ability of the service provider to determine the correct cost base, it is the opinion of Group Management that the prices paid by the Group companies have been set in accordance with the arm’s length principle.

The expectations from the tax authorities

<table>
<thead>
<tr>
<th>Transaction value</th>
<th></th>
<th></th>
<th></th>
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<tr>
<td>Service provider</td>
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<td>Amount (DKK)</td>
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</tr>
<tr>
<td>Company X</td>
<td>Company Y</td>
<td>8,149,058</td>
<td>TNMM NCP</td>
</tr>
</tbody>
</table>

Transfer pricing analysis

A number of comparable companies to the service provider was identified and the following arms’ length interquartile range was calculated:

<table>
<thead>
<tr>
<th>Interquartile range</th>
<th>NCP 2014-2016 W.AVR.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower quartile</td>
<td>3.50%</td>
</tr>
<tr>
<td>Median</td>
<td>4.90%</td>
</tr>
<tr>
<td>Upper quartile</td>
<td>5.85%</td>
</tr>
</tbody>
</table>

A Net Cost Plus of 5.01% could be calculated for the services provided.

<table>
<thead>
<tr>
<th>Actual figures</th>
<th>Tested Party</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>8,149,058</td>
</tr>
<tr>
<td>Costs</td>
<td>7,761,008</td>
</tr>
<tr>
<td>Profit</td>
<td>388,050</td>
</tr>
</tbody>
</table>

Due to the above, it can be concluded that the prices paid by the Group companies have been set in accordance with the arm’s length principle.
Summary of process and controlling
Establishing a proper framework

Analysis

- Define intercompany transactions in scope
- Understand the policy and data needed (i.e. cost types, gross margin, standard cost, deviations)
- Assess chart of accounts and data available
- Decide on basis for calculation (Excel, ERP module, separate software)
- Understand AS-IS processes for intercompany calculation and invoicing

Plan

- Define process for data gathering and calculation of prices
- Define process for analysis of calculated prices vs. TP policy
- Define process for record to report (i.e. invoice for intercompany transaction)
- Define ambitions for controlling and tax controls (including frequencies)

Executive

- Gather data and apply calculation methodology
- Controlling of TP policy and actual data (based on frequencies decided upon)
- Execute on control of controlling process

ERPTP PolicyProcessTax return
Next step in the journey could be to let technology enable the processes...

...but Excel can also be used if process is followed.
High data quality and technology enabled transfer pricing can take you even further

The future of tax controlling and monitoring
Annual cycle for transfer pricing purposes
The controlling process must be included in the combined transfer pricing annual cycle

1 Identification of intercompany transactions and preparation of benchmarks (November)
   • Identification of intercompany transactions for the existing FY.
   • Preparation of benchmarks to determine arm’s length prices for the intercompany transactions regarded significant in nature.

2 Year-end adjustments and information gathering meeting re. transfer pricing documentation (December)
   • Identification of 11+1 realised margins for the tested parties.
   • Identification of entities to be adjusted in order to receive remuneration within the interquartile range determined in the benchmark analyses.
   • 11+1 year-end adjustments to be performed.
   • Information gathering to start preparation of the transfer pricing documentation.

3 Year-end adjustments and preparation of transfer pricing documentation (January)
   • Identification of the realised margins for the tested parties before closing the books. Year-end adjustments are performed similar to the adjustments done in December.
   • Initiate preparation of transfer pricing documentation for the preceding FY.

4 Possible year-end adjustments and preparation of transfer pricing documentation (February/March/April)
   • Identification of the realised margins for the tested parties in the preceding FY after ended audit process. Year-end adjustments are performed similar to the adjustments done in December, in case reclassifications etc. have led to realised margins outside the interquartile range.
   • Information gathering for the transfer pricing documentation for the preceding FY.
   • Finalisation of transfer pricing documentation (if possible).
   • Controlling and possible adjustments for Q1 in the existing FY (around 20 April).

5 Review (May)
   • Check whether there are any unresolved issues or outstanding information regarding the transfer pricing documentation and solve these.
   • Final review of the transfer pricing documentation.

6 Tax return (June)
   • Submission of tax return(s) on 30 June (at the latest) in Denmark, unless the deadline is extended.
   • As of FY2020, a proposed bill in Denmark suggests that the transfer pricing documentation should be submitted to the Danish Tax Authorities no later than 60 days after submission of the tax return.

7 Planning (August/September)
   • Planning for the next 12 months.
   • Meeting with Deloitte to coordinate transfer pricing processes and manage expectations for the existing FY.
   • Impact assessment of new laws and proposed legislation.

8 Assessment (October)
   • Assessment and anticipation of transfer pricing specific issues for the company based on the first three quarters for the FY.
   • Evaluate any changes compared to the preceding FY.
Difficult times, extraordinary measures

- Unprecedented economic crisis following C-19 has had an instant impact on economic results, affecting the benchmark profitability ranges under the arm’s length standard.
- Need for adjustment of transfer pricing policies now, revisit APAs and intercompany contracts to cope with the impact of C-19 and navigate such challenging times.
- Any transfer pricing changes for 2020 cannot be supported by regular benchmarking as 2020 data will not be available until mid-2022 and historical data benchmarks would not be viable because previous years data do not readily reflect the crisis.
- Data and evidence-driven analyses consistent with the arm’s length standard would be needed to support any changes made to TP policies for 2020.

Different approaches to construct benchmarks capturing C-19 impact

- Conventional data adjustments
- Econometric regression analysis