The Transfer Pricing lifecycle

BEPS Action 13, which increases the compliance burden through a focus on Transfer Pricing documentation and Country-by-Country reporting, is a key driver of change.

Given the reach and complexity of Transfer Pricing policies, processes, and transactions across divisions and subsidiaries in multiple jurisdictions, it is prudent for companies to consider the four key elements of the Transfer Pricing lifecycle in reassessing their approach:

- **Plan**: Setting Transfer Pricing strategy by defining the policies and overall model
- **Manage**: Recording the outcomes of intercompany transactions in records and accounting systems
- **streamline**: Dealing with tax authorities through advance pricing agreements or audits (if raised)
- **Resolve**: Documenting the strategy and processes for review by tax authorities

The Transfer Pricing lifecycle
Aligning the elements

While many companies maintain a firm focus on the "plan," "manage," and "resolve" phases, less emphasis is often placed on the "streamline" phase of the lifecycle, commonly referred to as Operational Transfer Pricing (OTP). Incorrectly recorded outcomes are increasingly a target of tax authorities and the main cause of adjustments in most tax audits. Aligning all elements of the Transfer Pricing lifecycle—policy, documentation, and tax authority interaction—with OTP is essential.

Three key drivers of this development are:

- **Validity of Transfer Pricing policy.** The spotlight has intensified on individual businesses with added scrutiny and reporting requirements stemming from Country-by-Country reporting and newfound transparency into the nature and value of relevant transactions from master and local files.

- **Tightening tax authority requirements.** Some jurisdictions are increasingly reluctant to accept post year-end margin/costing adjustments.

- **E-audit requirements.** New measures are mandating that financial data be available in real-time (or at least within shorter timeframes) and are setting new data requirements for adjustments.
Because Transfer Pricing sits at the heart of a business's intercompany transactions, consequences of improper processing can be significant in terms of staff workload, quality, and costs. OTP is therefore an increasingly strategic concept for companies to understand and implement. It facilitates a holistic view of Transfer Pricing in the business and can result in fewer Transfer Pricing adjustments throughout the year. This reduces indirect tax (duties and VAT) risks and significantly reduces tax audit risks.

While there are varying thoughts as to which business function owns and runs the OTP process, finance in most cases, rather than tax, provides most of the input (even though the process is led by tax). An increasing number of companies are implementing broader finance transformation initiatives which can lead to enhanced data access, greater processing power, increased connectivity of Enterprise Resource Planning (ERP) and Enterprise Performance Management (EPM) systems, and shifts to shared services facilities (which remove finance capabilities from local businesses). Collectively, this points to a more automated and integrated OTP process.

OTP is an area which companies find increasingly challenging. Processes are often manual and ill-defined, and the split responsibility between tax and finance often means that accessing the right data is challenging. At the same time, no clear technology platforms that can easily be deployed to improve efficiency and accuracy have been developed. The increased scrutiny of tax authorities and focus on accurate recording of transactions creates a business case to implement efficient, automated, technology-enabled approaches to OTP. This will reduce the time needed to complete calculations, improve accuracy of the underlying data, and provide an audit trail for validation.

While it is clear that no preferred approach for undertaking this often complex, time-consuming process exists today, we see an automated solution integrated into key enterprise-wide technology platforms as the end game for OTP. Realization will require an in-depth assessment of the end-to-end processes and will likely mandate incremental improvements along the way.
Improving Operational Transfer Pricing

There are five key considerations in reviewing and improving an organization’s approach to OTP:

• **Identifying the relevant intercompany transactions.** Initially, the focus should be on key intercompany transactions that, for example, are the most material, take significant time to implement, or would result in the most risk if not implemented correctly.

• **Processes and controls.** Processes are often undocumented, which can result in issues with key dependencies and personnel changes. Sometimes the policy is documented, but not followed by local finance teams.

• **Data and measurement.** Issues involving data availability and integrity must be identified. For example, incorrect or incomplete general ledger descriptions can make it difficult to discern the correct costs and can lead to errors.

• **Technology.** The processing engine used to carry out the calculations is a critical component of OTP. While spreadsheets are employed in many organizations (and may be entirely appropriate), we are seeing a trend towards more automated solutions as companies’ ERP/EPM systems become more flexible and integrated. At the same time, some companies are looking to increase visibility, accuracy, and real-time monitoring of Transfer Pricing results, which would require a more sophisticated solution. While companies with that mindset currently remain in the minority, we expect to see a shift over the next five years.

• **People.** There can be a lack of clarity of roles and responsibilities regarding the correct recording of intercompany transactions. There may also be a lack of understanding by those who execute the processes (e.g., the finance team calculating the management service charges via complicated spreadsheets).
Two straightforward steps can help identify risk areas and determine a plan of attack:

- **Assess the current state.** Evaluate the people, data, processes, controls, and technology to highlight areas requiring improvement. More often than not, this exercise sheds light on the real problem area(s) within the overall process, whether it is a key dependency, a lack of common processes, or a highly manual set of activities.

- **Create a roadmap.** This should set out a clear path for improving the OTP process and its accuracy. Key steps could include:
  - Examining key intercompany transactions to determine the current process and the further capabilities required.
  - Mapping the process by identifying who is responsible, what are they responsible for, whether the processes are consistent (most often they are not), etc.
  - Identifying simple improvements in controls and processes to improve efficiencies and/or mitigate risk.
  - Identifying data sources and how they are accessed in order to simplify or automate the process.
  - Determining whether technology (other than spreadsheets) can be used to improve the process, save time, and reduce risk.
Key considerations for creating a roadmap

In creating a roadmap, the key is to establish a clear vision of who owns the process (tax, finance, etc.) and the central roles played by each function. Three essential actions are:

01. Articulating a vision for the solution, instead of highlighting the problem. Detailing a realistic approach to achieving an outcome—and supporting it with a costed, vetted business case—is much more likely to gain buy-in with stakeholders than simply creating a list of issues. Find business advisers who can assist in defining the future state, building a roadmap through to implementation, and preparing a stakeholder workshop. It’s not uncommon to see business tax requirements be initially rejected by program teams or stakeholders. A detailed plan of the proposed solution, including change, costs/cost savings, resourcing, and other key impacts, is often what opens their eyes.

02. Working in the “currency” of those to be influenced. In any change program or finance transformation initiative, garnering buy-in with relevant stakeholders is essential. Accordingly, it’s important to work in their common “currency.” For example, if the stakeholders are most interested in cash savings, there is little point in discussing reduced resource load. Or if the primary concern is headcount, then the conversation shouldn’t focus on effective tax rate benefits. In addition, be certain to use any associated terminology, jargon, or language which resonates with the audience. By tailoring the message and “walking in their shoes,” a more direct translation can be made to their day-to-day activities.

03. Supporting the stance. Whether a single project plan (e.g., implementing a Transfer Pricing solution) or feeding into a wider program (e.g., part of a business-wide finance transformation), any OTP change program needs to demonstrate sufficient return on investment for the organization. Building a convincing business case is essential in bringing stakeholders along the journey. Examples of core qualitative and quantitative elements in an effective business case include:
   - Explanation of the significance of the transactions in question (since the volume of data is generally not fully appreciated outside of the Transfer Pricing team).
   - All of the priority risks to be mitigated.
   - Current levels of provisions against Transfer Pricing adjustments.
   - Summary of increased process efficiencies (i.e., hours to be saved or repurposed).
The practice of OTP has traditionally suffered from a lack of available options in terms of dedicated technology. More recently, however, ERP providers and tax software developers have intensified their focus on defined solutions for Transfer Pricing management.

For ERP vendors, the addition of Transfer Pricing capabilities into their products is fueled by the desire to respond to increasing client needs in this space. For example, Oracle’s Tax Reporting Cloud offers Country-by-Country reporting as well as tax reporting functionality, complemented by wider Transfer Pricing functionality within other modules.

In addition, the use of existing modules within planning and profitability management functions facilitates broader monitoring and calculation activities. For example, SAP’s S/4HANA suite provides implementation partners with an extensive toolkit for streamlining the design of OTP software solutions.

While tax technology software houses with OTP solutions continue to invest, other providers, who previously focused on transaction tax engines or tax reporting, are now entering the market. This convergence and competition is likely to ultimately result in stronger technology options for tax functions.

In addition, a number of digital technologies are entering the scene and may offer additional avenues for OTP improvement. Solutions employing Robotic Process Automation (RPA), blockchain, and machine learning are all in the very early stages, but we expect these to evolve into viable alternatives for increasing efficiency, improving accuracy, and reducing costs in OTP processes.
Transforming Transfer Pricing processes today

Multinational companies that do not reconsider their approach to OTP and seek to transform their overall policies may face unnecessary risk from both a Transfer Pricing and business perspective.

Simple improvements in processes and controls can make OTP more efficient, further integrate technology, and drive automation deeper into processes.

In tax operations, this may translate to:

- **Increasing the frequency of the Transfer Pricing process.** At a minimum, the monitoring and calculation process needs to be run quarterly; however, most businesses strive to make it part of the standard month-end close. Being able to use forecast data and set pricing in advance is becoming an objective for many companies. This not only reduces indirect tax risk (which is often ignored in pricing adjustments) but reduces or eliminates year-end adjustments which are often a starting place for revenue authority scrutiny.

- **Reducing the Transfer Pricing process run-time.** While this represents an essential prerequisite in a company’s ability to run the process more frequently, it also fundamentally reduces the overall bandwidth dedicated to OTP within the business.

- **Enhancing dashboards and leveraging data analytics.** Analytics can help the tax function to derive hidden insights from the Transfer Pricing data, and dynamic dashboards accelerate the review process with C-suite leaders and other key stakeholders.

- **Establishing clear audit trails.** Spreadsheets cannot maintain a clear workflow which validates when or by whom changes were made. A clear audit trail can be invaluable in tracing actions and assisting with tax authority audits.

- **Strengthening workflow.** A Transfer Pricing process methodology and controls framework can actively monitor progress, notify stakeholders of obligations or actions, mitigate the risk of failures or errors, and facilitate streamlined reviews and approvals.

It is essential for tax functions to always consider what they want to achieve with the new process and then figure out how technology can support achievement of that goal. This contrasts with the often misplaced approach of starting with new technology and letting it dictate the path forward. The difference is subtle, but important. By starting with the desired process, businesses empower technology to work for them rather than letting available functionality dictate how tax processes are run.
As a result of intensifying revenue authority scrutiny and many tax authorities’ desire to request and analyze data, it is imperative that tax functions not only review if their Transfer Pricing policies are fit for purpose but also how these policies are being implemented within the business.

Creating the requisite momentum for change can be challenging, but an expanding universe of Transfer Pricing specific technology options is creating new opportunities to implement efficient approaches to OTP.

Process automation ultimately enhances both clarity and consistency, and helps tax departments to address increasing global compliance demands with confidence.

Deloitte’s global network of Transfer Pricing specialists is ready to assist with your OTP concerns, including articulation of a policy, creation of a business case for change, identification of business requirements, evaluation of technologies, process optimization, project implementation, and organizational governance.
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