Emerging transfer pricing landscape in the digital world

Today, we are in the midst of dynamic and compelling changes happening in the global tax regulations and the tax enforcement methods, as well as increasing enterprise-wide transformation. As other parts of an organisation adopt new technologies, a multinational corporation’s tax department will be mandated to look beyond business as usual, and transform its tax operating model to provide greater value to the business. The tax technology is moving at a much faster pace – from licensing of compliance tools to the managed services model, and collaborating in enterprise transformation. It is now becoming more of a strategic decision aiming towards the tax department’s value proposition rather than mere tax compliance needs.

Forward-thinking multinational corporations are revisiting their transfer pricing policies and processes with emerging technologies and automation opportunities. In parallel, COVID-19 has contributed to an acceleration of digital transformation. This transformation is taking place throughout the end-to-end supply chain, with faster and broader adoption of data and predictive analytics, cognitive automation and Artificial Intelligence (AI), robotics, digital supply chains, smart factories, and e-commerce.

Historically and over the past two decades, transfer pricing was driven primarily by manual computations. Multinational corporations viewed their transfer pricing obligations solely as an annual compliance affair. When the OECD launched the BEPS project, evolving implications arising from various BEPS Action Plans, including Action Plan 13, started forcing multinational corporations to find more efficient, integrated means to manage transfer pricing affairs and processes. Simultaneously, OECD recommendations are being expanded as additional local legislative requirements by many countries and tax authorities across the globe are expecting more details and exactness (while undertaking audit and assessments). Consequently, businesses are now under more pressure than ever to find efficient ways to manage their transfer pricing affairs, processes, data, and documentation-related matters.

In 2020, although the tax department was aware of the potential technology and automation opportunities, the tax and transfer pricing teams have never been the frontrunners in technology adoption and continue with age-old practices. This mindset needs a change now as next-generation technologies, such as robotics, AI, machine learning, blockchain, and data analytics, are set to transform the way tax departments have been functioning.

Given that tax and transfer pricing teams have to deal with massive data sets and manual processes (to decipher and analyse such tax data), there is a need and opportunity to use automation and technology solutions in everyday aspects of transfer pricing. Technology would assist in implementing and scaling automation capabilities to manage repetitive tasks and exploring how to use data more effectively to generate insights. Technology and automation would also assist in reducing the number of man hours required, increasing efficiency and accuracy of data, and in turn, rising the reliability of data and reports.
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Use of technology in transfer pricing
As highlighted above, transfer pricing is usually considered as one of the last areas of tax to embrace technology and automation. However, without technology/automation, organisations will find it impossible to mitigate their tax/transfer pricing reporting risk; streamline, standardise, and optimise their transfer pricing processes; identify data gaps and access to real-time data to make analytical decisions; and make data-driven predictions and business decisions.

Keeping this in mind, we have put together some transfer pricing workstreams wherein technology/automation can be used by multinational corporations’ tax departments. Below are some emerging transfer pricing use cases wherein we are experiencing that tax departments are starting to use innovative technology-based solutions:

a) Data extraction, processing, and visualisation
Data collection has always been an ad hoc and labourious process in transfer pricing analysis. Multiple classifications, segmentations, and rework is required for data analysis. Various compliance requirements may need extracting huge data and accurate reporting in a prescribed format.

For instance, Indian transfer pricing regulations require filing of an accountant’s report, a master file, and a Country by Country (CbC) report as a part of transfer pricing annual compliance. The technology-enabled transfer pricing documentation process is an example of how technology can be used to streamline the efficient preparation of TP documentation reports. Using a web-based interface, data can be uploaded and sorted into requisite modules. These modules can further be edited and assembled into compliant reports without duplicating efforts. Such a technology-enabled, transfer pricing documentation process can help organisations streamline information; reduce manual efforts required in customising TP reports for various countries; and provide accurate, consistent, and quality reports.

Apart from these, big data and robotics can assist organisations in managing the possible data overlap wherein same data set is filed and reported with other tax regulators, such as income tax authorities, GST authorities, customs authorities, and the registrar of companies.

With the advent of big data and software (with huge processing power), data volumes are no longer a limitation. Instead of data sampling, estimating, and extrapolating, professionals will work with precise and complete data sets. Real-time reporting could also become a reality in the future when tax authorities are asking for entire data sets instead of samples.

b) Operational transfer pricing
The OECD’s BEPS Action Plan 13 initiative and the evolving transfer pricing landscape have augmented the transfer pricing policy implications worldwide. Streamlining the transfer pricing process is almost as important as planning and executing it. This is where Operational Transfer Pricing (‘OTP’) would assist users. Multinational organisations often encounter inconsistent transfer pricing data from business units that dramatically increase the complexity and staff workload. In many tax audits/assessments, this is one of the major reasons for huge transfer pricing adjustments. OTP helps in aligning the entire transfer pricing life cycle, ranging from policy formulation and documentation, to tax assessments.

The OTP process can help organisations integrate their transfer pricing policies with day-to-day operations, improve integrity of inter-company accounting, increase operating efficiencies, and reduce risks in various areas. Stakeholders in multinational corporations can rely on OTP to provide them an assurance that the agreed upon transfer pricing policies are being followed on the grassroots level across nations.

OTP can also assist in erasing anomalies arising due to incorrect and inefficient transfer pricing data, such as year-end or quarterly adjustments (resulting in volatile margins across different years), custom/VAT issues (arising from differential payments), and allocation of cost amongst group entities.

Using a technology platform in OTP would facilitate a proactive transfer pricing process with in-year monitoring, analytics, and adjustment capabilities. It would also ensure accurate implementation of transfer pricing policies and provide an improved tax insight to the tax department.

Further, OTP can help create a tax data warehouse, and a staging area for the relevant transfer pricing data from various sources. Tax data warehouses provide companies the ability to centralise data for tax purposes. This would ensure prompt access to accurate, correct, and complete data with easy retrieval capabilities.

c) Blockchain and transfer pricing
Using the concept of blockchain, businesses can track, trace, and authenticate products; record contracts; guarantee the movement of information; record transactions; etc. Specifically, from a transfer pricing construct, inter-company agreements are often hard to formulate and difficult to reconcile, considering multiplicity of intercompany transactions in a large multinational corporation set-up. Using blockchain, the tax department can explore formulating and tracking smart contracts, facilitating consensus of inter-company transactions and policies, and assisting in the calculation of inter-company transaction values consistent with agreements.

d) Decision-making, dashboards, and reporting: AI elevating compliance and consulting capabilities
As rightly said by Carly Fiorina (ex-CEO of Hewlett Packard), “the goal is to turn data into information, and information into insight”. Strategic decision-makers need structured and meaningful data.

Until now, tax software programmes were mostly compliance oriented. The focus on analytics was almost non-existent. Even data analytics was primarily used to apprehend large data volumes that gave users a hindsight on the data used. In the current and near future, we expect tax departments in multinational corporations to use AI for predictive and prescriptive analysis. In this analysis, past data is analysed to form predictive statistical models projecting future tax outcomes. Prescriptive analysis further deciphers these projections, and chart out plans and strategies.

From a tax standpoint, such analysis may be used to monitor year-on-year data to analyse tax and legal trends from case laws, flag potential outliers from the Cbc reporting, understand the DEMPE (Development, Enhancement, Maintenance, Protection, and Exploitation) functions of intangible assets, etc. Data analytics tools can also be used to identify potential opportunities, risks, anomalies, and trends by analysing the inter-company data to the granular level.
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Conclusive remarks
To stay abreast of future demands, the tax and transfer pricing teams would need to expand their horizons, and adopt and learn new technologies to stay relevant. Multinational corporations would need to take a deep dive into their current transfer pricing approach and processes, and evaluate their needs and expectations from technology. Reimagining the entire transfer pricing process using technology could be the best way to get the most out of digitisation. This would help organisations adopt the correct technology platform suitable to their needs.

By combining technology with skilled workforce, multinational corporations’ tax and legal departments will get the much-needed facelift. Better delivery turnaround time, a reduction in overall costs, maximising efficiencies, and adoption of best practices with futuristic analytics and dashboards for the key management teams would help the organisation in more ways than one. Thus, the need of the hour is to cultivate a culture within the tax function that embraces new ways of working with technology, and focuses on people and technology working together in a collaborative system.

The tax function’s future now lies in our hands. An open and changed mindset will help us achieve success, and ensure our ability to work confidently now and in the future!