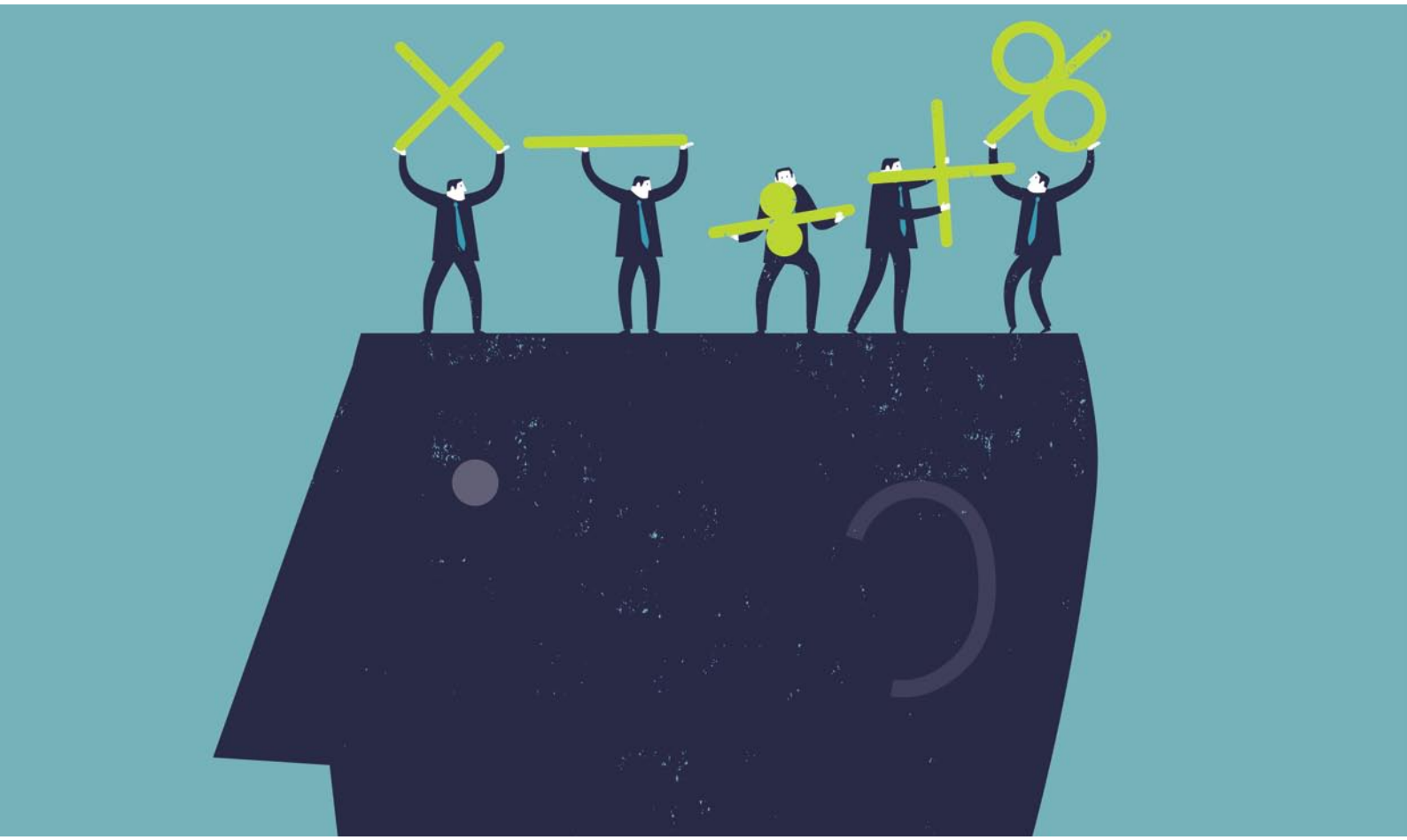
ROUNDTABLE

Transfer pricing

REPRINTED FROM
FEBUARY 2015 ISSUE

FINANCIER WORLDWIDE corporatefinanceintelligence

ROUNDTABLE



TRANSFER PRICING

The transfer pricing environment has undergone significant change over the past 12 months. High-profile developments, such as the introduction of the Organisation of Economic Co-operation and Development's (OECD) base erosion and profit shifting initiative, have heavily impacted the transfer pricing arena, providing infinitely more scope for addressing disclosure, intangibles, risk and dispute resolution issues. Although the extent to which countries incorporate the new OECD initiative into their transfer pricing legislation remains to be seen, one thing is clear: the transfer pricing landscape continues to evolve.

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Luis Carrillo is a transfer pricing specialist with 15 years of advisory experience, including Big Four and the transfer pricing software industry. He is the director of transfer pricing solutions at Bureau van Dijk (BvD) and is responsible for guiding BvD's transfer pricing solutions widely used by corporates, advisory firms and tax authorities worldwide. Prior to BvD, Mr Carrillo worked as a transfer pricing adviser at KPMG, Arthur Andersen and EY, focusing on intangible property valuations, transfer pricing planning and global compliance.

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Fabio Gaspar is a tax lawyer and tax law professor. Mr Gaspar specialises in tax planning and consulting on Brazilian and international taxation, with a background in tax litigation and corporate law. He has authored papers and lectured on tax subjects in distinguished publications and forums. His current role includes being the transfer pricing focal point for Brazilian upstream assets. Prior to joining Shell he worked at reputed law firms in Brazil.

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Michael Barbour is general manager for the Westpac Group and is responsible for the group's global tax management and strategy. This includes overall responsibility for tax policy, risk management and strategic issues affecting the group, and areas such as capital management, group treasury, mergers and acquisitions, as well as human resources. Mr Barbour has been with Westpac for more than 15 years, beginning in 1998 as tax controller and moving into head of group tax in 2001.

FW: What do you consider to be the most significant changes or developments to have taken place across the transfer pricing landscape over the previous 12 months? To what extent have these changes impacted upon organisations and their operations?

Behrend: Without a doubt, the Organisation of Economic Co-operation and Development's (OECD) base erosion and profit shifting (BEPS) initiative is the most significant development. Backed by the G20, the OECD launched a 15-point action plan in July 2013 to combat the perceived abuses from BEPS strategies. A global agreement is unrealistic, as countries would essentially have to surrender some degree of their fiscal sovereignty to fully adopt the initiative. Countries will simply pick and choose which proposals they will adopt and enforce, creating new challenges for multinational organisations by having different rules to be followed on a country-by-country basis.

Carrillo: The progress the OECD is demonstrating with regard to the BEPS project is the most significant development taking place. The BEPS project will have an impact in the medium to long term, as it is yet to be seen if and how countries incorporate the new OECD Guidelines into their transfer pricing legislation. Action 13 of the BEPS project is particularly relevant to all multinational enterprises (MNEs). To the extent countries adopt the recommendations under Action 13 in their legislation, MNEs will actually have more documentation and disclosure requirements than they do today. Moreover, the level of disclosure recommended under Action 13 by MNEs is likely to open the door to more scrutiny, as the information disclosed in the country-by-country reports, in the absence of a functional and an economic analysis, will raise more questions than provide answers for the tax authorities.

Brimicombe: The OECD BEPS initiative has had the single largest impact on the world of transfer pricing in terms of its scope to address disclosure, intangibles, risk and dispute resolution. These actions started with the intention of curbing aggressive tax planning but they also risk recasting the transfer pricing framework for all related party transactions. Even though not all BEPS transfer pricing guidance has been agreed and published, corporates are beginning to assess the changes required to meet country by country reporting, master and local file information requirements, as well as trying to take into account the likely direction on intangibles and what this means for existing arrangements and future planning.

Fletcher: There have been major developments over the last 12 months heralding enormous future change. The OECD's BEPS project is extremely relevant for transfer pricing. Some of the BEPS Actions are transfer pricing-specific and will result in an overhaul of the OECD's transfer pricing guidelines affecting aspects such as intangibles and in particular risk and recharacterisation. Other BEPS Actions will have a significant impact on transfer pricing practices, and the UK government's own proposals for a diverted profits tax have transfer pricing at their core.

Barbour: Internationally, the most significant developments have arisen from the BEPS work of the OECD and G20. This work covers 15 Action areas which broadly relate to increasing transparency of taxpayers' affairs, and deal with significant transfer pricing issues relating to the digital economy, allocation of income to permanent establishments and integrity measures relating to interest deductions, valuations of intangibles and prevention of treaty abuse. In Australia, transfer pricing rules have already been re-written. These require companies to self-assess their transfer pricing compliance and have documentation in place by the time of lodging their 2014 tax returns.

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MICHAEL BARBOUR

Gaspar: Transfer pricing is still relatively new in Brazil compared to elsewhere in the world, hence changes and improvements are gradual. Looking at the most relevant changes to have taken place lately, I would refer to some areas where we have come closer to arm's length standards, bearing in mind that Brazil does not follow OECD's guidelines, but rather provides for formulary approaches on transfer pricing. Some of those are the PECEX exportation method and the use of market parameters on pricing commodities, as well as the first ever Oil & Gas Production Sharing Agreement signed in the country, which provided for transfer pricing-like rules for related-party transactions with a clear precedence of arm's length pricing over formulary methods.

Johnson: We are seeing more changes to transfer pricing frameworks now than we have seen in the past 20 years. In 2014 alone, the OECD released nine draft reports with new guidance on transfer pricing issues under its BEPS initiative. In addition, several countries issued new regulations implementing BEPS-like measures in areas where the OECD had not yet even finalised guidance. The areas that seem to be generating the most activity from companies include the OECD's Guidance on Transfer Pricing Aspects of Intangibles, the OECD's new country-by-country reporting requirements, and an increased focus on financial services transactions.

Steedman: Without doubt, the OECD's BEPS project is the most significant development within the last year, and it is still ongoing. For those organisations that have the resources, the current impact is essentially time being taken reading, considering, absorbing and responding to the numerous, interconnected 'action' documents which have been issued.

FW: Are tax authorities now placing greater importance on the issue of transfer pricing to a noticeable extent? In what ways is this manifesting itself?

Fletcher: Tax authorities are scrutinising transfer pricing matters as much as ever, but they now have a wider range of tools in their ▸▸

armoury. In consequence, dispute resolution has taken on even greater significance, and there is increased demand for Mutual Agreement Procedures (MAPs) alongside a general rise in the desire for advance pricing agreements.

Behrend: Tax authorities are definitely placing greater importance on transfer pricing, as there appears to be a growing consensus that MNEs are not paying their 'fair share' of taxes. This results in a new playing field for the corporate tax world, with a multitude of anti-abuse initiatives and measures being proposed and adopted at an international level. The overriding premise that tax authorities are trying to follow is that profits should be taxed where the economic activities generating the profits are performed and where value is created.

Carrillo: Tax authorities have been placing importance on the issue of transfer pricing. This is not particularly new. It is a trend that has been in existence for the past 15 years, but it shows no sign of dissipating. One need only compare the number of countries with transfer pricing requirements in 1995, when the first OECD Guidelines came out – five countries – to the number of countries with transfer pricing requirements today – over 65 countries.

Steedman: A notable fact is that almost 300 senior tax officials from more than 100 countries and international organisations met in September last year for a global forum on BEPS. Around the globe, there continues to be new countries introducing transfer pricing legislation every year, including, for example, Albania and Tanzania in 2014. In the UK, where there has been an emphasis on transfer pricing for many years, transfer pricing enquiries have yielded in excess of £5bn over the last six years and hence will continue to be an area of focus for the UK tax authorities.

Johnson: We are seeing increased focus on transfer pricing worldwide. The pace at which countries are issuing new transfer pricing guidance has greatly accelerated. In addition, many tax authorities are actively participating in the OECD and United Nations' transfer pricing dialogues to ensure that the end result is a favourable one from their perspective. In the US, the Internal Revenue Service (IRS) is focusing intensely on transfer pricing, but the organisation is working under a reality of resource constraints.

Gaspar: There can be no doubt that transfer pricing will now be a permanent fixture on the Revenue Service's agenda. While we have been seeing more tax audits and tax assessments being issued, the authorities are becoming more open to technical discussions with taxpayers and private practitioners. On a greater level, the fact that Brazil is participating in the BEPS discussions is also indicative of the importance it has been given.

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FABIO GASPAR

Barbour: There is a significant focus by the Australian Parliament and media on perceived tax avoidance from the use of low tax rate jurisdictions by MNEs. Whilst the Australian Taxation Office (ATO) has, for many years, had a significant focus on transfer pricing issues, it has intensified with the OECD/G20 work on BEPS and the public discussion in Australia. The ATO has had a focus on the use of marketing hubs in low tax rate jurisdictions as well as the provision of digital services from offshore locations.

Brimicombe: In our particular sector, transfer pricing has always been of great importance, owing to high operating margins and the extent of IP driven profits. However, it is noticeable that the level of scrutiny has dramatically increased over the past decade as more countries have developed their understanding of transfer pricing related risks to their respective tax bases. Their response often starts with legislation requiring taxpayers to meet the arm's length standard and to provide formal transfer pricing documentation. However, tax authorities vary considerably in their application of the arm's length test and OECD guidance, which leads to increased risk of double taxation.

FW: What indications have there been that governments have stepped up their enforcement policies over the past 12 months? How are they doing this?

Steedman: Greater enforcement often begins with greater levels of information gathering. For example, the Czech Republic is expected to introduce a questionnaire which will form part of the income tax return for 2014. The questionnaire collects information about transactions with related parties, such as the volume of services, royalties, interest and dividends, sorted by individual corporations. Similarly, the Argentine Tax Authority has recently required taxpayers to disclose their relationships with domestic and foreign related parties within 10 working days of the formation of the related party relationship.

Johnson: In the US we have seen several actions taken by the IRS to prioritise transfer pricing in audits. In February of 2014, the IRS released its Transfer Pricing Audit Roadmap, a 26 page document outlining the stages of a transfer pricing audit. This document emphasises upfront research and communication, and helps the IRS make use of limited resources to identify the most important transfer pricing issues as early as possible during an audit. Another recent example was the IRS's announcement in December that it would be training a large number of domestic auditors on international issues.

Gaspar: Over the last couple of years, transfer pricing legislation has been tweaked to enhance some aspects of it as well as to close loopholes identified by the Revenue Service. Some of those changes happened after discussions with taxpayers, which may pave a path to 'enhanced relationships' – a concept our company is particularly supportive of following our positive experience in other countries and top management support in pursuing this in Brazil. Simpler compliance has been a sub product of some changes – for example, the possibility of using Posted Price for commodities on regulated activities – PECEX, which makes it ▸▸

easier to produce evidence before the authorities that the parameter price has been utilised simply by comparing the invoice with the regulator's published price. On a broader level, the absorption of IFRS accounting standards in Brazil also shows a tendency to fix historical differences in global practices – evident in the interest Brazil has shown toward BEPS discussions.

Barbour: There has been a clear step up in enforcement activity which has manifested itself as increased revenue office audits and Australian law changes requiring greater transfer pricing documentation. The government has provided additional funding to the ATO to undertake transfer pricing compliance activities. The Australian government also chaired the G20 in 2014 and is an active supporter and advocate of the OECD/G20 BEPS action plan. Of late there has been a significant focus on profit shifting by MNEs and there has been a great deal of media speculation that the Australian government will introduce a 'diverted profits tax' similar to that announced by the UK in the Chancellor's 2014 Autumn Statement.

Carrillo: Governments are definitely stepping up their enforcement of policies. We see this in the rise in the number of transfer pricing enquiries, especially in emerging markets like India. We also see governments stepping up their enforcement in the increase in resources, such as staff, databases and risk-assessment software, being allocated to transfer pricing. One example is how most tax authorities have gone from subscribing to local (FAME) or regional (AMADEUS) databases, to subscribing to global (ORBIS) databases that give tax authorities information on companies on a global scale, and provide comparables for outbound intra-group transactions.

Brimicombe: The increased development of transfer pricing legislation and documentation requirements is often followed by the exercise of these new powers through enquiries and assessments. The quality of analysis and basis for assessments varies, and while some authorities are willing to engage with taxpayers, others prefer to pursue their cause in the courts – not always with success. The most significant gap in the process as far as many corporates are concerned is consistent access to mutual agreement procedures and mandatory binding arbitration.

Behrend: Mexico and the UK have already adopted the BEPS country-by-country reporting rules into law. In response to the BEPS proposals and related public pressure from politicians and the media, certain other countries in Europe have begun to propose legislative changes and are changing historic ruling practices that will result in increases in worldwide effective tax rates for many companies. These changes have been selectively applied in the early stages, but it seems that there is a broader desire to change previously acceptable practices, and stricter enforcement of economic substance is expected.

Fletcher: The UK tax authorities have a tight framework governing enforcement and compliance. This consists of a board of Commissioners, including the Tax Assurance Commissioner who oversees a Tax Disputes Resolution Board, with several Boards below that, including a Transfer Pricing Governance Board as well as an Enforcement and Compliance Disputes Resolution Board. The Transfer Pricing Board saw 36 cases in 2013-2014. The tribunals and courts issued decisions in 39 avoidance cases in 2013-14, with 30 decided in HMRC's favour, leading to collections of £2.7bn of tax.

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TODD E. BEHREND

FW: In the case of cross-jurisdictional joint audits, are tax authorities now more inclined to work together? How does this approach assist participating countries and what does this mean for multinationals?

Johnson: We are finding several examples of situations where tax authorities are more inclined to work together. This is occurring not only between pairs of countries, but groups too. Recently, members of our UK practice helped a company resolve a three-way cross-jurisdictional joint audit between Sweden, Denmark and Finland. In addition, there has been an increased preference by MNEs for multilateral Advance Pricing Agreements (APAs) instead of unilateral options. This reflects a reading of the current environment by many taxpayers as one in which tax authorities wish to work together.

Steedman: To date, there have been few details of cross-jurisdictional joint audits. But there is increasing evidence of information sharing between tax authorities, and the clear political will of cooperation demonstrated by the BEPS project suggests that sharing of information and the possibility of joint audits is only likely to increase. Cooperation between tax authorities is further evidenced by the OECD's Tax Inspectors Without Borders Initiative, currently underway trialling the training of tax officials in developing countries in the skills required to undertake tax audits. These include international tax matters and the completion of bilateral advance pricing agreements negotiated between two tax authorities; recent examples of which are between India and Japan and the UK and Korea.

Behrend: The OECD has agreed that greater cooperation will be necessary to effectively implement the BEPS project and automatic exchange of financial information. Cross-jurisdictional audits are likely to increase to the extent that the BEPS principles are broadly adopted. This exchange is in its infancy in several European countries but has not been broadly implemented in North America. For MNEs, this means that global documentation will need to be made available to tax authorities as part of transfer pricing audits. Inevitably, this will result in more extensive and expensive audits, as tax authorities will feel obligated to audit the additional information that they are now receiving.

Brimicombe: My understanding is that joint audits are rare, pri- ▸▸

marily owing to logistical and budget obstacles. However, there is noticeable increased cooperation among tax authorities to exchange information in respect of taxpayers, particularly in the case of suspected avoidance. We are conducting a number of transfer pricing resolution processes involving two or more tax authorities and the advantages include single documentation and submissions and the opportunity to develop consensus on issues and approaches to resolve them. So far, the process of information submissions has been efficient and joint meetings have been possible.

Gaspar: Despite the fact that Brazil has double taxation treaties providing language on transfer pricing, especially exchange of information, I have never heard of an actual example where a coordinated cross-jurisdictional audit has taken place. One reason may be the lack of credits arising from transfer pricing adjustments, or perhaps the fact that Brazil is still developing in this space.

Fletcher: Our view is that tax authorities are increasingly working together on audits. Indeed, recent developments at an OECD and EU-level mean that automatic information exchange will soon be the norm, including details of tax rulings. This means that tax authorities will more easily be able to target and pursue aggressive transfer pricing arrangements on a joint basis.

FW: Have you observed an increase in transfer pricing disputes between organisations and tax authorities in your location? Do you believe that governments and tax authorities are now more likely to consider litigation as an option for dealing with multinationals that have transgressed?

Barbour: Recent press reports indicate that the ATO has been auditing a number of MNEs and generating additional revenue. It is understood that, as well as proposed legislative changes, the Australian government expects that there will be a number of court cases where the existing transfer pricing rules will be tested.

Gaspar: Regarding tax disputes, but bearing in mind that it will not necessarily arise following a transgression, interpretations of the legislation can vary and the correct one will often only be known after due process. Brazil has been seeing an increase in tax assessments related to transfer pricing of late. It almost necessarily means litigation, due to the way procedures are designed in Brazil, as it inaugurates administrative litigation all the way to specialised administrative tax courts and, in the event the taxpayer is unsuccessful at the administrative level, usually the discussion is taken to judicial courts. The whole process can take more than a decade up to a final decision at the judicial Supreme Court level. Procedure follows the same path for all tax cases and is not specific to transfer pricing. It is a rather painful process which barely allows compromise as an alternative form of dispute resolution. It is also worth noting that while the administrative courts are composed of tax professionals, judicial courts are led by generalist judges, often lacking tax specialisation, which can cause additional litigation time or even uncertainty on the result.

Intangible property transactions have been the subject of the highest profile transfer pricing cases in the past several years, and 2014 was no exception.

MICHELLE JOHNSON

Johnson: In the US we are seeing an increase in disputes in specific areas. Intangible property transactions, especially those involving migration of IP outside of the US, have been the subject of the highest profile transfer pricing cases in the past several years, and 2014 was no exception. Business restructurings, including those involving inversions, have drawn significant attention within the last year. Services transactions such as management fees have also caused significant controversy. In all cases we are seeing the IRS be very strategic in the cases it selects for litigation. Companies have become increasingly wary of litigation.

Fletcher: There has been an increase in the number of disputes, particularly in cross-border disputes. However, these can only proceed at the rate of the slowest tax authority involved, so there are many unresolved cases. There is no way forward to resolution if certain countries are involved. This is often not usually a result of lack of resources, such as staffing, but of approach. Most countries will want to achieve a fair result, but others will want to maximise their allocation of the tax take. Litigation in transfer pricing is now a more likely option generally across jurisdictions, although not as yet in the UK. However, when the diverted profits tax takes effect in April 2015, there is likely to be an increase in litigated cases.

Brimicombe: In the UK there is a steady increase in the number of APA submissions, MAP procedures and audits supported by an increased level of resources allocated to HMRC for dealing with such matters. Over the last few years, improvements have been made to the governance and assurance processes for dealing with transfer pricing and tax disputes more broadly. This has helped to increase transparency and confidence in the system. In addition, there is an established guidance on litigation and settlements which sets out criteria for pursuing litigation. Transfer pricing matters rarely fall into a straightforward case for litigation and very few of these types of disputes progress to the courts in the UK.

Steedman: Transfer pricing statistics issued by the UK government indicate that the number of transfer pricing enquiries open at any one time is relatively static. Furthermore, in the UK there still appears to be little appetite for litigation as a means of resolving transfer pricing issues. HMRC prefers to approach and resolve transfer pricing enquiries through discussion between its own specialist staff, the organisation concerned and their advisers, with litigation as a last resort.

Behrend: In North America, there has not been a significant increase in transfer pricing disputes, mainly because the US and Canada have a large array of venues for an MNE to find relief from audit disputes, such as the appeals process, arbitration, mediation, competent authority, and an active APA process. Mexico has also remained largely static in the numbers of transfer pricing disputes, but this may change in light of the expected increase in taxes to ▸▸

be paid under the new *maquiladora* regime. In Europe, various court cases dealing with 'mismatches' between international tax structuring and economic reality have ruled in favour of the tax authorities.

FW: What can we learn from some of the high-profile transfer pricing disputes that have surfaced during the past 12 months? What impact are these likely to have on how other organisations view their transfer pricing strategies?

Brimicombe: Many of the disputes in transfer pricing have been reflected in examples referred to in OECD guidance or have been reported widely as they have been listed for hearings. The focus has been the tax authorities' concern with mobile assets including cash and intellectual property. Mobility resulting in the separation of ownership of assets and economic activity necessary to develop and exploit the asset is the key cause for concern among many governments as reflected in the ongoing work of the OECD and UN. Where such separation is artificial and inconsistent with arm's length behaviour, there is a clear case for laws, regulations and guidelines to impose proportionate adjustments in order to reflect commercial arrangements that would have been entered into between unrelated parties.

Gaspar: Transfer pricing disputes, as with all tax disputes in general in Brazil, are privileged while at the administrative level. It is, therefore, difficult to follow up on administrative litigation cases currently. Furthermore, to date there have been very few judicial cases completed. The lack of paradigm decisions to guide taxpayers on how to interpret legislation is an additional source of uncertainty, since either other taxpayers will not know about transfer pricing administrative court decisions, or they will find out about them too late.

Fletcher: There has undoubtedly been an increase in the politicisation of MNEs' tax affairs, including their transfer pricing strategies. In the UK, senior officers of MNEs have been subjected to thorough questioning by the Public Accounts Committee, and public awareness has never been higher. The recent publication of the State Aid preliminary decisions in respect of tax rulings granted by Luxembourg and Ireland to certain MNEs has served to keep transfer pricing very much in the public eye.

Barbour: The SNF and Chevron cases, as well as the recent amendments to Australia's transfer pricing rules, indicate that it will not be enough for taxpayers to produce evidence that prices are consistent with those charged to third party purchases or borrowers but that "the proposed arm's length consideration must ultimately make commercial sense for the actual taxpayer in its actual circumstances". There is also increasing use of joint audits and information sharing between revenue authorities.

Johnson: Intangible valuation issues continue to be the focal point of litigation in the US. At issue in many of these disputes is the compensability of certain intangibles. Certain rules in US tax law exclude certain items like goodwill, going concern value and workforce-in-place, from the definitions of compensable intangibles. However, the IRS has argued that under the arm's length standard the transferor would expect to be compensated in such a way that may imply that these items should be taken into account. In addition, financial services transactions are under intense scrutiny. As of late 2014, about a quarter of cases pending in US tax courts involve disputes over financial services issues, especially intercompany loans. Finally, financial risks from transfer pricing litigation can be enormous. Companies with pending transfer pricing cases in US courts are facing potential income adjustment amounts in the hundreds of millions, even billions, of dollars.

A group's transfer pricing policies and approach to international tax in general can become a reputational issue with much more at stake than the tax.

RUTH STEEDMAN

Steedman: The key message from the recent past is that transfer pricing is no longer confined to the tax department – a group's transfer pricing policies and approach to international tax in general can become a reputational issue with much more at stake than the tax. In the UK, Google, Amazon and Starbucks have all received significant press coverage and public outcry with respect to reported tax benefits attributed in the media to transfer pricing. We have seen the emergence of a trend within an organisation to consider more broadly commercial and reputational matters as well as the technical aspects of the potential impact of their group's transfer pricing policies.

Behrend: In North America, there have not been any true high-profile transfer pricing disputes in the last 12 months. A notable dispute occurred in Canada in the Nortel Networks case, which dealt with transfer pricing as well as bankruptcy issues. In 2014, the US seemed to focus on procedural and administrative guidance on approaches to enforcing the current law in the transfer pricing arena of audits and APAs. It has long been noted that the IRS and Canadian Revenue Authority (CRA) are aggressive audit regimes and are not afraid to challenge taxpayers on what they deem to be positions and policies taken for the primary purpose of evading taxes.

FW: What are the main difficulties that multinationals face as they seek to maximise tax efficiency while remaining compliant with transfer pricing regulations?

Carrillo: One of the difficulties that MNEs face is the inconsistency in the application and interpretation of the OECD Guidelines from one country to the other, as some requirements in some countries conflict with the requirements of others. There is also a growing insistence by emerging markets that valuable intangibles are present in their local jurisdictions, and that more profit should be attributed to their jurisdiction. Further, it can be challenging to find independent comparable data with which to justify the arm's length nature of intra-group transactions.

Fletcher: The main difficulty is that proposals to transform inter- ▸▸

national tax are on the table, so MNEs are facing massive change, but also uncertainty, since it is not clear at this stage exactly what action different countries will take, and the impact that this will have. The UK has made its intentions clear by launching a consultation on how it plans to implement the OECD's proposals on tackling hybrid mismatch arrangements, and by pushing ahead with its diverted profits tax. There seems to be broad support across Europe for making changes, but the position of other countries, including the US, is not clear.

Brimicombe: The vast majority of MNC's are trying to comply with multiple sets of rules – state, national and international – that attempt to address the issue of pricing the transfer of goods and services between related parties. This task is made significantly more challenging owing to the variation in interpretation of guidelines by tax authorities compounding the administrative burden of the multiple reporting and monitoring requirements. The OECD, to its credit, has attempted to standardise not only the technical aspects of transfer pricing but, more recently, the reporting documentation in order to address the current burdens for tax payers and tax authorities.

Behrend: In today's BEPS environment, the main difficulties an MNE will face are substance and perceived profit shifting. To the extent that the legal owner contracted out all or part of the important functions to one or more affiliates, BEPS states that all or a substantial part of the return attributable to the intangible would be allocated to the affiliates performing the important function. In that case, the affiliates' taxing jurisdictions will likely seek to ascertain whether they can deem any of those functions to be creating an intangible in the local jurisdictions.

Gaspar: The first difficulty companies find in Brazil when carrying out transfer pricing is the gap between local transfer pricing rules and other countries' rules, notably the OECD's guidelines. While the former is based mostly on formulary methods, the latter is based upon arm's length – and reconciling both can be rather challenging. Lack of certainty in applying local methods can also mean additional difficulty as a result of the limited paradigms stemming from rulings issued by the Revenue Service and from courts. For example, the lack of specific rules on intangibles can cause many possible interpretations without any direction offered by rulings or case law.

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IAN BRIMICOMBE

Barbour: In this context, tax efficiency clearly should not mean double non-taxation, as this is precisely the concern that has given rise and life to the OECD and G20 work on BEPS. MNEs should, however, be concerned that their international dealings do not give rise to double taxation. There is a clear danger that during this BEPS development phase, MNEs will not have sufficient tax certainty or clarity to avoid this position.

Steedman: The main difficulty is the changing landscape created by individual country transfer pricing legislation additions and changes, and the overlaying of the BEPS project outcomes. In particular, the significant focus within the transfer pricing elements of the BEPS project towards an emphasis on substance over form will require significant attention by all groups with transfer pricing policies and for most, a review of existing policies against the new framework. In addition to the changes to the OECD transfer pricing guidelines themselves, there is the added complication of their application in each individual country. The timing for when the changes become law, if indeed they do, will vary from country to country, and if not enshrined in law then the degree to which they are followed by each local tax authority will vary in practice, adding another layer of complexity.

Johnson: Today, companies' biggest obstacle to effective tax planning is uncertainty. With the deluge of new guidance being issued by non-governmental bodies like the OECD and the UN, and new regulations being issued by tax authorities, the basis for the biggest drivers for many tax planning decisions is changing every few months. Companies whose tax departments are effective at risk-based decision making will be best equipped in this environment. A secondary challenge is volume. It may no longer make economic sense for many MNEs to produce unique transfer pricing reports covering every intercompany transaction in every country where documentation requirements exist.

FW: How should companies respond if they become the subject of a tax audit or investigation? What documentation needs to be made available in this event?

Gaspar: When it comes to audit or investigation, the best position for the taxpayer to be in is to have prepared in advance. Having a strong internal process to analyse transactions in advance, doing thorough work when applying the chosen method, having an adequate legal framework, and keeping documentation organised in advance, are key for a smooth scrutiny process in Brazil. It is worth emphasising that a thorough internal process within the organisation, with clear responsibility and accountability between departments to ensure a proper audit trail, should be maintained on costs and documentation.

Brimicombe: My advice would always be one of cooperation and collaboration where possible. Very often, a tax authority will need to understand the global business model and detailed intra-group trading relationships in order to have the relevant context to make any assessment of risk and potential adjustment in relation to a transfer pricing matter. Advancing this understanding should enhance the audit process. However, taxpayers are not always invited to explain their position, in which case the submission of transfer pricing documentation and responses to questions on a timely basis may be all that can be done ahead of any assessment. Litigation would be the last resort, as it is inevitably heavily fact-dependent, often concerns years in the past where data and witnesses are less available, and can be very expensive.

Barbour: Clearly, companies should ensure that their transfer pricing policies and supporting documentation are kept up to date. For example, initiating a pre-lodgement meeting to establish ground rules and the type of documents required allows a company to manage the revenue office relationship. Undertaking a review of internal documentation for quality, type of documents and their availability assists with managing the investigation. Ensuring a reasonably arguable position is available at the time the tax return is lodged to justify the application of arm's length condition is essential. Usually the transfer pricing policy should contain a functional analysis, particulars of the method used and comparable circumstances, and the actual commercial and financial conditions of the enterprise. Finally, companies should provide clear and complete responses in a timely way.

Behrend: Companies are advised to always be timely and compliant when responding to a request for audit. MNEs need to prepare themselves to be able to provide the requested tax information on a country-by-country basis. Information will increasingly be shared by tax jurisdictions worldwide, resulting in a substantially increased tax and transfer pricing compliance and audit burden. As a consequence, MNEs should devise a strategic plan to be consistent in their responses so that if exchange of information is invoked under a treaty, the responses to one jurisdiction are not contradicted or incriminating in another jurisdiction.

Fletcher: The key response for companies facing an audit is to communicate clearly and effectively about what's happening within their group, both at home and abroad. All groups are expecting their effective tax rate to increase, so they need to anticipate. They should review their existing structures and if the substance to support those structures is lacking, they need to make changes.

Carrillo: Companies should respond to tax enquiries by being upfront about their transfer pricing policies and their operating results. Having transfer pricing documentation in place – including intra-group agreements, a functional analysis explaining the functions and risks of the relevant legal entities involved, and an economic analysis to substantiate the arm's length nature of the transfer pricing policy – is the best way to shift the burden of proof onto tax authorities, and to minimise the risk of adjustments and penalties. Companies we work with value having access to our tools for transfer pricing analysis, as they are able to quickly respond to such tax enquiries as they arise, and produce a first line of defence in audit situations.

Johnson: Companies should make sure they can respond quickly once an audit notice is received. Notices are often sent to the local operating entity in the country that is the subject of the tax audit, and precious days or weeks of the available response timeline might be wasted if that notice is not immediately directed to the tax team. We always recommend being cordial and responsive to tax audit requests to avoid problems associated with bad relations with the examiner. Most initial information requests for transfer pricing audits in the US include the 10 principal documents specified in the relevant Treasury Regulation.

Steedman: The first step is to read the letter from the tax authority in question and get very clear on the scope of the enquiry. Are they asking about all related party transactions or just some? What years of account are they interested in? Are they enquiring as a matter of routine or because they believe that the transactions are not at arm's length? The next step is to understand what documentation exists as compared to the requirements and undertake the work needed to fill any gaps in the time provided by the relevant legislation taking professional advice where necessary. The exact documentation requirements will vary by country but essentially its purpose will be to demonstrate the arm's length nature of the related party transactions usually supported by third party comparables. Speed is of the essence, as many countries have tight time limits for the presentation of contemporaneous documentation to mitigate penalty risks.

Having transfer pricing documentation in place is the best way to shift the burden of proof onto tax authorities, and to minimise the risk of adjustments and penalties.

LUIS CARRILLO

FW: In your opinion, have changes to tax regulatory requirements made it tougher for multinationals to understand potential tax liabilities, or, conversely, have they reduced uncertainty as to the risks and opportunities within a company's tax structure?

Barbour: The combination of the OECD/G20 actions on BEPS, increased audit activity and increasing documentation requirements are all increasing the focus on MNEs' transfer pricing arrangements. This focus and the development of new rules means that MNEs are in fact operating in a period of increased uncertainty, and hence increased risk. This risk is exacerbated where countries take unilateral action, such as the Diverted Profits Tax in the UK or where information provided under country-by-country reporting leads to transfer pricing adjustments in various jurisdictions. However, the outworking of the BEPS' action plans and tax transparency initiatives could, and are intended to, facilitate greater clarity and consistency in the application of transfer pricing rules between jurisdictions. Over time, this should provide MNEs with greater certainty over their transfer pricing arrangements.

Behrend: There have been certain changes in the regulatory environment that have reduced uncertainty for MNEs. For example, the implementation of the advance pricing agreement program in India has provided certainty for up to five years prospectively. This has the potential to substantially reduce uncertainty in dealing with the often volatile enforcement regime that exists there for transfer pricing matters. On the other hand, transfer pricing regimes and enforcement have continued to evolve haphazardly on a global basis, which has increased the uncertainty in dealing with tax rules that change from year to year. There is also uncertainty that arises from the continued approach of certain countries, such as Brazil, that insist on maintaining a transfer pricing regime that is not based upon the arm's length principal and inevitably leads to double taxation.

Steedman: The BEPS proposals are currently increasing the uncertainty surrounding MNEs' tax positions. In addition to all the transfer pricing changes, there are also proposed changes – hence uncertainty surrounding other international tax issues such as permanent establishments. Furthermore, it is highly likely that the level of confidence of tax authorities around the world to tackle all types of transfer pricing enquiry will steadily increase. Current proposed changes to regulatory requirements and an ever increasing likelihood of enquires are making it harder for MNEs to forecast potential tax liabilities.

Fletcher: There have not been changes to regulatory requirements, but there has been a change in attitude on the part of the authorities who are applying regulations more rigorously. For example, financial regulations add an extra dimension in the form of capital requirements and how to respond from a transfer pricing perspective. Capital is becoming scarcer, yet companies are required to hold more capital under the changed rules, and this has had an impact. Another concern is the conflicting messages that regulatory bodies and tax authorities might take away from the same source.

Carrillo: Over the past 15 years, the main changes to regulatory requirements have been in the proliferation of those requirements to more and more countries. Though most countries have adopted or have followed the OECD Guidelines, their interpretation and application of these Guidelines does vary and often results in uncertainty and double taxation. Also, the increased focus on intangibles by emerging markets like India has increased the level of uncertainty for MNEs.

Gaspar: In some respects, the main challenges in connection with doing transfer pricing in Brazil comes from the different rules applicable locally compared to UN/OECD Guidelines. That gap has been gradually closed though through policymakers seeking rules more in line with the arm's length principle, as we can see in the aforementioned PECEX method. Another area where regulatory changes have been made in connection with transfer pricing is on the charter of upstream vessels, which are now subject to stricter regulation and inclusion of a new related party instance, which goes beyond ordinary transfer pricing rules, following Federal Law 13.043/2014.

Johnson: We are in the midst of a unique season of regulatory developments. The OECD has issued many draft sets of guidance on MNEs' most important tax issues, and, with the exception of certain nations that have already implemented BEPS-like measures, such as the UK, France, Mexico and Australia, the world is still waiting to see how the guidance gets finalised and incorporated into countries' tax law. At present, uncertainty is high.

Financial regulations add an extra dimension in the form of capital requirements and how to respond from a transfer pricing perspective.

RICHARD FLETCHER

Brimicombe: Changes over the last decade have generally been progressively helpful to improve shared understanding of the international transfer pricing framework. However, as more countries have woken up to the potential risks to their respective tax bases as a result of transfer pricing, there has been an increasing volume of local rules and reporting demands for businesses to manage. Essentially, in the last five years there has been a shift in risk from established countries with tried and tested transfer pricing practices to emerging markets, which approach transfer pricing with a different starting point and various interpretations of the arm's length outcome not necessarily aligned to the view of established markets.

FW: What do you expect to see happening in the area of transfer pricing over the next few years? Do you expect companies to keep a close watch on developments in tax policy?

Johnson: In the near term, I expect countries to continue issuing one-off BEPS prevention actions even before the OECD finalises its BEPS guidance. The United Kingdom's 'diverted profits tax', France's anti-hybrid measure, Mexico's newly created BEPS audit unit, and Australia's tightening of thin-capitalisation rules are all examples of this trend. And, as the European Union and Asia-Pacific nations begin to identify regional solutions to BEPS, I would expect more countries will certainly follow.

Brimicombe: Significant change and potentially increased uncertainty will result from the current OECD BEPS review. In order to address a minority of taxpayers engaged in aggressive tax planning, the OECD is likely to propose significant changes to existing transfer pricing guidelines, for example in analysing risk and the application of recharacterisation and other special measures. Such changes have the potential to increase the variation in interpretation and increase uncertainty for taxpayers and tax authorities.

Carrillo: Over the next few years, I expect the OECD BEPS project to reach its conclusion and a new set of transfer pricing guidelines to be issued. As these new guidelines take shape, more and more countries will adopt the new guidelines into their legislation – particularly as they relate to documentation requirements, country-by-country reporting, intangibles and intra-group finance. Country-by-country reporting requirements, to the extent that these are adopted by more and more countries, will raise the level of scrutiny and the number of enquiries by tax authorities.

Steedman: It will be essential for companies to examine the impact of BEPS and other local country developments on their transfer pricing policies. In particular, all transfer pricing policies and the supporting documentation will need to be reviewed in light of the changing attitude to the location of value creation and the increased focus on both functions and the allocation of risk and capital.

Behrend: Over the next few years, many countries, especially in Europe, Latin America and India, will adopt the BEPS initiative in some form. As a consequence, I believe that audits, both cross-ju- ▸▸

risdictional joint audits and traditional audits, will increase and become more aggressive on a global basis. Companies will certainly respond to increased assessments and increasing global effective tax rates with an increased interest in tax policy. It is unlikely that structures with low levels of substance will be supportable in any form in the future, but the migration of MNEs' operations from high-taxed countries to lower-taxed countries will continue as long as companies are measured on their after tax profits.

Barbour: I would expect a lot of activity in relation to transfer pricing over the next several years. The OECD is due to complete its work on the BEPS action plan in December 2015 and then individual countries will need to determine how, when and in what form the OECD recommendations are to be adopted and implemented. In addition, MNEs will need to implement country-by-country reporting. Companies will need to understand these rules, participate in their development where appropriate, and implement country-by-country reporting.

Gaspar: Brazil seems very interested in the BEPS discussions being held by the OECD, but, in my opinion, will not easily give up the control and 'simplicity' offered by the local formulary approach. The creation of specific rules for intangibles is greatly expected and a new IT tool is being implemented by the Revenue Service – Siscomex – the aim of which is controlling data related to importing and exporting services and goods in country, and will likely be utilised with very close connection to transfer pricing, specifically depending on how the intangibles rules will be released.

FW: What final piece of advice would you give to organisations that are looking to review and amend their existing transfer pricing policies?

Behrend: Companies should perform a BEPS global transfer pricing compliance 'health check', and ask themselves a number of questions. Do you have transfer pricing documentation that supports your positions and is it in line with the economic reality of your current supply chain in each jurisdiction and the supply chain as a whole, considering that the taxing jurisdiction will have a full view of the profits of your entire supply chain? What is the company's global supply chain policy? Does that policy have substance for each function performed in each local taxing jurisdiction? Does the policy need to be altered in view of the BEPS Action Plan? Companies also need to develop country-by-country reporting using the OECD template to ensure they have all of the pertinent information and system support to comply.

Steedman: The direction of travel appears to be towards ever greater examination and detail as to the location and division of intangibles, people functions, value creation, risks and capital among companies within a group. However, there is currently no indication that the quality and level of detail of the information available in relation to third party comparables will be improving. Hence, there may be increasing gaps which will need to be filled with strong, innovative and thoughtful economic analysis if companies are to be able to continue to support the arm's length nature of their arrangements with third party comparables, as is generally the requirement.

Gaspar: As far as Brazil is concerned, authorities should be more and more sophisticated in scrutinising transfer pricing. Given the fact that local rules are somewhat open to interpretation all transactions need to be carefully documented and the legal grounds on which they rely need to be well detailed in advance. Aside from that, having an independent report on the chosen method and documentation from an external consultancy, following the tax ruling Solução de Consulta Cosit 13/2013, may also help as it can now be officially offered and may prove useful during tax audits.

Carrillo: At the end of the day, a company's transfer pricing policy should be a reflection of the overall business organisation as well as the value chain. MNEs should definitely engage in a periodic review of their transfer pricing policies to ensure these are in line with the overall business organisation. To the extent that if an MNE's transfer pricing policy doesn't properly reflect the business organisation or the overall value chain, it should be amended. The best way to minimise the level of risk arising from amending one's transfer pricing policy is to have proper documentation of the business reasons for changing the transfer pricing policy. Companies should also demonstrate how the new transfer pricing policy better reflects the realities of the business, and support the arm's length nature of the new transfer pricing policy with an economic analysis.

Fletcher: Organisations should follow their business purpose closely. Putting artificial structures in place without the necessary substance will cause them to be shot down in a post-BEPS world, in particular the requirement for country-by-country reporting. All groups should assume that all information about their structures will be available to all taxing authorities, so structures will either need to be changed or defences to challenges will have to be put in place.

Barbour: Be aware of the changes to transfer pricing rules both domestically and internationally, participate in their development where appropriate and make sure that transfer pricing documentation is adequate and robust. Make sure that the company's transfer pricing policies are applied consistently and reflect the economic substance of the activities undertaken. Finally, be prepared to defend your transfer pricing policies and positions with the revenue authorities.

Brimicombe: My advice would be to start with a thorough analysis of the business model and then to develop or amend transfer pricing policies to allocate profits in alignment with physical activity, asset ownership combined with management and decision making and the capability to manage risk. This is not necessarily straightforward, particularly in a highly integrated MNC where activities, decisions and management are not always organised in or aligned to discrete legal entities or even countries. However, given the direction of the OECD BEPS project, any gaps between profits and economic activity are increasingly likely to be questioned and require detailed explanations.

Johnson: More than ever, it is imperative that companies centralise their transfer pricing policies and tailor their global support efforts in proportion to risks. MNEs that decentralise transfer pricing documentation responsibilities and leave them in the hands of local controllers will be less efficient in collecting information that is necessary to make strategic decisions and comply with the world's rapidly changing requirements. Centralising transfer pricing responsibilities within a global tax department can allow companies to handle today's uncertainty through strategic decision making and ensure that companies spend their valuable resources on their most important issues. ■