CAPLIN & DRYSDALE

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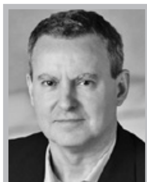
TRANSFER PRICING

Transfer pricing (TP) is one of the most relevant and important topics for tax departments at multinational enterprises (MNEs). Amid an increasingly complex and stringent regulatory environment, spearheaded by the Organisation for Economic Co-operation and Development's base erosion and profit shifting project, it is essential that MNEs regularly review and update their TP processes to ensure compliance with global TP rules and to minimise the risk of disputes with tax authorities. ■

THE PANELLISTS



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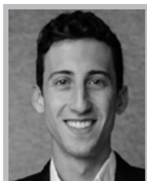

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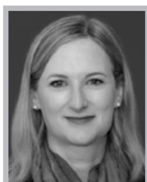

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Emma Donnelly joined FTI Consulting in 2022 from a big four firm and is a senior managing director in the UK tax practice. Through a career spanning more than 20 years, she provides clients with corporate tax advisory services, including international tax and transfer pricing (TP). She has worked with businesses ranging from small and medium enterprises to FTSE 100 in many sectors. Her experience includes business operational efficiency projects, intellectual property planning, TP dispute resolution and debt-related TP projects.

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Dr Martin Lagarden is an experienced industry practitioner with a broad background in R&D, economics and taxes. His responsibilities as Henkel group's head of global transfer pricing (TP) span system development, domestic & international tax audit management and dispute resolution, documentation and related topics, as well as digitalisation in operational TP. He has co-authored several publications on different aspects of TP, including but not limited to intangibles, their valuation and documentation issues.

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FW: Could you provide an overview of the main trends currently shaping the transfer pricing environment?

Armitage: The US global intangible low-taxed income (GILTI) rules changed the landscape of international taxation. Eventually, all countries likely will have some GILTI analogue, only stronger. Corporate income tax rates likely will increase because GILTI-like taxes raise the rate floor. In addition, developed countries face enormous debt burdens and likely will remain aggressive in transfer pricing (TP) enforcement. While a minimum tax can materially reduce the benefits of 'tax-haven' TP, higher corporate rates and aggressive enforcement increase the need for effective dispute resolution and the motivation for seeking it. These trends are likely to deepen over the next decade.

Wingen: The global tax and TP discussion is currently dominated by the work of the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework to address the tax challenges arising from the digitalisation of the economy. The outcome, once agreed and implemented, might rewrite the century old international tax standards on how to allocate profits within multinationals. As of now, the profit allocation is based on the arm's length standard, which – in simple terms – prescribes to conduct and price transactions within a multinational group as if they occur between independent parties. The proposal from the OECD/G20 Inclusive Framework known as Pillar One would add an additional step to this profit allocation by reallocating a portion of a multinational consolidated profit to market jurisdictions, where users and consumers are located. The mechanics of Pillar One are formulaic, so it may be the start of abandoning the arm's length standard and introducing a global formulary apportionment. Besides this, two other hot topics are, firstly, the impact of sustainability developments and, secondly, the impact of enhanced mobility of employees on a multinational's profit allocation.

Lash: The key trend currently shaping the TP environment is increased attention and enforcement efforts by tax authorities worldwide. TP audits are becoming much more common, and tax authorities have had increased success in imposing TP adjustments. The OECD base erosion and profit shifting (BEPS) project takes aim at TP both directly, under actions 8-10, and indirectly, under actions 1, 4 and 13. Action 1's 'Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy' is currently the 'top priority' for the OECD/G20 Inclusive Framework and is similarly top of mind for many TP practitioners.

Lagarden: I see four major TP trends. First, the general move to more transparency in tax and TP, consequentially linked to increasing tax controversy in and among countries and leading to a number of new reporting requirements for multinational enterprise (MNE) taxpayers. Second, the urge to achieve international political alignment and coordinated action against harmful tax competition and toward a 'new world tax order', driven by the OECD and countries in the Inclusive Framework on BEPS. Third, an increasing focus on environmental, social and governance (ESG) topics and the debate about their relation to TP. Fourth, on a more operational level, accelerated and enhanced information sharing, automation and digitalisation efforts in TP analytics, documentation, management and reporting, combined with the search for talent in those areas as key members of TP teams. Major contributing stakeholders are the OECD, national fiscal authorities, the European Commission (EC), the United Nations (UN), the International Monetary Fund (IMF), the World Bank and, last but not least, multinationals themselves, reacting to these trends.

Orlandi: In recent years, TP has become, probably, one of the most relevant topics for multinationals' tax departments. Moreover, the TP environment is becoming increasingly complex, and multinational companies need to make more effort to manage their TP policies to reduce disputes with tax authorities. In this regard, the main recent TP trends include the following. First, the rise of the digital economy has raised new issues related to how to allocate profits among different tax jurisdictions. Second, governments around the world have increased their efforts to ensure that multinational companies are paying their fair share of taxes, which has led to more audits and more disputes. Third, the coronavirus (COVID-19) pandemic has had a significant impact on global trade and profit allocation among both unrelated and related parties. Fourth, several countries have updated or changed their TP rules and guidance. For example, Brazil recently announced the implementation of a new TP legislation substantially consistent with OECD standards. Fifth, the increasing importance of intangible assets, such as intellectual property (IP) and brand value, has led to an increase in the complexity of managing TP policies. Finally, 'Amount B', if approved, and Pillar Two will substantially increase TP efforts and compliance activities for multinationals.

Donnelly: I am currently observing the following trends in the market. First, legislative changes are influenced by tax authorities aiming to understand the whole value chain of an organisation as well as the operations within their own jurisdiction, in order to assess whether there is value being created in their jurisdiction which is not being adequately remunerated relative to the entire organisation. Second, both the media and organisations now apply a moral lens to the application of legislation, so it is not just a question of whether an arrangement is legal, but also whether it is morally justifiable. Third, within organisations there is a growing appreciation of managing reputational risk, and that includes being able to say that they are paying their fair share of tax. Finally, tax authorities are focusing on the correct implementation of TP policies. It is not enough to have documentation in place – TP needs to be applied correctly with the correct transactions in the right territories, paying the correct amount of tax.

Odimma: The rapid increase in commercial globalisation and the OECD discussion on digital tax have accelerated the pace of TP developments in Africa. African tax authorities are positioning themselves to access a substantial share of the 'potential tax windfall' of the Pillar One and Pillar Two OECD projects. The impact of the COVID-19 pandemic has placed more pressure on tax authorities, leading to more aggressive behaviour with respect to tax collection. One of the trends seen across Africa is the use of the median range in an arm's length range. Ordinarily taxpayers are expected to choose any point within the interquartile range where the benchmarking results achieved by comparable companies are close together and the range is small. Any point within the range should be acceptable for the purpose of comparability. In recent times, most Africa tax offices have insisted on proposing adjustments from the median range and upward. Another trend is the increase in TP legislation such as country by country reporting (CbCR) and stricter penalties for failure to submit the reports. Some countries are requesting actual submission of CbC reports by subsidiaries in their country instead of waiting for reports through automatic exchange of information from the tax office in the parent company. In addition, most countries are moving to adopt the OECD directive on low value adding intangibles in their respective domestic legislation.

Bhatia: I have noticed three main trends in the TP environment. First, the increasing use of technology by taxpayers and tax authorities, including the use of no-code solutions to streamline TP processes. Second, an increase in the TP compliance burden, including local files, master files and non-standardised unique TP forms for many countries. And third, a general uplevelling in the TP skillset of tax authorities globally. Tax authorities have now started to focus on more sophisticated TP issues. Against this backdrop, we have also seen a decrease in the time required to resolve mutual agreement procedure (MAP) cases.

FW: In your opinion, have the changes made to tax regulatory frameworks helped multinationals to understand their potential transfer pricing liabilities?

Wingen: The simple answer is, not really. Applying the arm's length standard in practice is and has always been extremely challenging. On the one hand, it is very fact-based, which requires a good understanding of industry specific business models. On the other hand, it is also acknowledged that there is no one correct transfer price, but at least a range of reasonable transfer prices. Due to these inherent challenges of TP, it is hard for multinationals to set transfer prices and easy for tax authorities to challenge them – leading to uncertainty around actual tax liabilities. This is despite widely available guidance, such as the 'OECD Transfer Pricing Guidelines', which now comprise 655 pages. However, Pillar One proposes one promising simplification: 'Amount B' envisages an agreed predetermined return for marketing and distribution activities. This would provide more certainty on remuneration for these activities.

Lash: Recent changes to TP guidance have helped multinationals to understand that they may have potential TP liabilities, but significant uncertainty remains regarding what those liabilities may actually be. That is, companies understand that their TP will be scrutinised, but are left wanting clarity on how to set their TP to withstand such scrutiny. In light of this uncertainty, some companies are turning to advance pricing agreements (APAs). Unfortunately, negotiating an APA is an expensive and time-consuming process that does not always result in agreement between the company and all relevant tax authorities. For many companies, tax insurance is a superior option for managing TP risk. Tax insurance can be obtained in a matter of weeks and provides protection to a company in the event that its TP positions fail to qualify for the intended tax treatment in the US or abroad.

Lagarden: The framework provided by the OECD TP guidelines and the UN TP manual provides helpful guidance for all interested stakeholders to inform their TP actions and to consider respective consequences. But this soft law framework and undeniable international standardisation effort has limited reach. Factors making it harder for multinationals to understand their potential TP liabilities include unilateral regulatory action by, and divergent tax regulations in, countries where some authorities seem to consider themselves smarter than others – a shifting but competitive tax landscape. There is also an unfortunate political unwillingness to

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> MARCO ORLANDI
> Shell International B.V.

compromise with reference to 'national tax sovereignty', for example, when it comes to finding an international agreement on binding arbitration mechanisms or other tax dispute resolution measures designed to reduce double taxation. This makes it harder for multinationals to strike a balance between compliance, legal certainty and economic risk taking.

> THE MOVE BY SOME COUNTRIES TO CONDUCT A PILOT FOR APAS IS A WELCOME DEVELOPMENT AND WILL AFFORD TAXPAYERS SOME LEVEL OF CERTAINTY WITH THEIR POTENTIAL TP LIABILITIES.
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> SEBASTINE ODIMMA
> MAERSK Transport and Logistics

Orlandi: Overall, the TP environment is increasingly complex, and multinational companies need to proactively manage their TP arrangements to ensure compliance with tax laws and minimise the risk of disputes with tax authorities. In recent years, several efforts have been made to provide more clarity and practical guidance on how to apply TP. For example, thanks to the BEPS project, additional clarifications and several practical examples have been included in the 'OECD Transfer Pricing Guidelines'. In the same way, the 'United Nations Practical Manual on Transfer Pricing' has recently been updated with more examples and more clarity. However, several grey areas remain – and need to be addressed as soon as possible to reduce the tax dispute burden for both multinationals and tax administrations.

Donnelly: TP has been one area of tax gaining increased focus from tax authorities for a number of years. This is evidenced by the increasing levels of tax revenues arising year-on-year from TP audits. For example, HM Revenue and Customs' (HMRC's) TP yield in 2020/21 was over 2.5 times the figure recorded in 2015/16. Accompanying this has been additional guidance published by the OECD, and tax legislation globally is being updated regularly and becoming more prescriptive. This is helpful for businesses to understand their compliance obligations and ultimately liabilities. However, within regions and globally, the requirements vary, which means local requirements need to be checked. The increased focus has prompted businesses to spend more time assessing their TP, increasing the quality of their documentation to support TP policies and, ultimately, the tax liabilities they pay.

Odimma: The pace of changes made to the tax regulatory framework has been fast. Multinationals are already struggling to keep up to date with the changes even though failure to meet any of the new rules will result in penalties. Some of the changes are still subjective and interpretations vary depending on the tax inspector reviewing a case. As such, taxpayers are still far from certain on their potential tax liabilities. In some cases, the changes create more ambiguity than certainty around the tax treatment of a particular transaction. That said, the move by some countries to conduct a pilot for APAs is a welcome development and will afford taxpayers some level of certainty with their potential TP liabilities.

Bhatia: Changes made to the TP regulatory framework have had a mixed impact. Certain changes, such as the introduction of Chapter VII guidance on low value-added activities in the 'OECD Transfer Pricing Guidelines', has resulted in an increase in certainty and therefore better understanding of potential liabilities. However, certain other changes, like the guidance on attributing profit to permanent establishments and on profit split methodology in the OECD Guidelines, have not provided meaningful help to the taxpayers on these complex and often controversial issues. While these are good reference papers, I do not think we are any wiser, as a taxpayer community, with this additional guidance, nor has it resulted in a meaningful reduction in controversies in these areas.

Armitage: In addition to GILTI, two US developments have fundamentally altered how companies must approach US TP. The 2017 Tax Cuts and Jobs Act eliminated companies' ability to move goodwill, going concern and workforce-in-place out of the US tax net in a tax advantaged way. Where companies might once have placed large residual values on those items, thus reducing values associated with other IP and operations, the incentive for distortion is now reduced. Similarly, the US 'adoption' of development, enhancement, maintenance, protection and exploitation (DEMPE) has narrowed the potential for material allocations of profits to 'cash boxes'. These developments have freed companies to take and defend more middle-of-the-road approaches to valuing IP, which better positions them to rationalise their global TP and defend their positions on audit.

FW: What challenges face multinationals in their efforts to maximise tax efficiencies while meeting compliance requirements?

Lash: In my view, the primary challenge faced by multinationals is not the direct burden of compliance itself, but the indirect burden of uncertainty. Sophisticated multinationals have robust tax compliance functions, but even the best tax departments cannot create certainty where ambiguity exists in the law. This is especially true when it comes to TP. Because it is often difficult to obtain a high level of comfort that a TP position will be respected by all relevant tax authorities – especially if the position involves unique IP – companies may be dissuaded from implementing a structure even if it is expected to result in tax savings. Companies facing this type of challenge should consider tax insurance as a tool to facilitate efficient planning.

Lagarden: The main challenges for multinationals are caused by divergent TP regulations and unilateral regulatory action implemented by governments. This is leading to more uncertainty and less flexibility to operate on the part of multinationals, depending on their TP risk appetite. One example is in the area of documentation: the general master and local file contents suggested by the OECD, since many years are often extended by local regulations, asking for additional taxpayer information, for example in China or India, or for additional TP forms to be filed mandatorily, for example in Belgium. With a view to benchmarking, which is indispensable to provide conclusive evidence of taxpayer's adherence to the arm's length principle, even in Europe local documentation requirements vary widely, with respect to independence indicator selection, geographic scope requirements or updating frequency, despite well-known OECD suggestions. Consequently, harmonisation and standardisation of compliance tasks can be much harder for multinationals to achieve.

Orlandi: Ensuring compliance with TP rules and other tax laws and regulations is a resource-intensive activity, and multinationals may face challenges in allocating sufficient resources to tax compliance. On top of that, TP rules can vary from country to country, and several countries have substantially changed or updated their internal legal framework toward alignment with OECD standards. In this regard, digital compliance tools can simplify the work of tax departments by automating many time-consuming and repetitive routine tasks, such as reviewing contracts and legal documents or analysing large sets of data. However, obstacles to having these new technologies working effectively do exist, especially with regard to privacy and confidentiality issues, and compatibility with current enterprise resource planning (ERP) systems.

Donnelly: Changes in tax legislation driven by the OECD BEPS agenda in 2015 made it challenging for some organisations to continue with their old structures. More recently, the new OECD Pillar One and Pillar Two proposals in response to taxing a digitalised economy may potentially limit the level of tax efficiency going forward. The focus of tax authorities on aligning profits with substance means that planning involving intangibles or high value creating activities needs to be properly analysed in order to ensure that it works not only from a commercial position within the business but also from a tax and compliance perspective.

Armitage: A key challenge for multinationals is the aggressiveness of TP enforcement. A large majority of countries may have formally adopted the 'OECD Transfer Pricing Guidelines' or the 'United Nations Practical Manual on Transfer Pricing for Developing Countries', but some continue to take positions on audit that are out of synch with those rules and that sometimes lack a rules-based approach. A significant number of countries still set targets for additional tax collections from TP audits. Companies may be forced to negotiate special, non-arm's length arrangements up front – a process at odds with the OECD and UN guidelines – or to endure long, costly and uncertain controversies. Mandatory binding arbitration, adopted through the OECD Pillars or bilateral treaties, could address some of these issues.

Odimma: Rapid changes in TP legislation represent a major challenge as taxpayers struggle to keep pace. Knowledge of TP changes is the first step toward proactively managing potential risks. Failure to comply with changes to filing obligations may result in huge penalties. Another challenge is the growing resource challenge within tax offices, resulting in rushed audits with proposed adjustments and limited time to understand the taxpayers' business and

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> Henkel AG & Co. KGaA

industry. This approach leads to a high degree of uncertainty and risk of huge adjustments.

Bhatia: In general, taxpayers have seen a substantial increase in their compliance burden globally. However, this extra compliance burden is not accompanied by an increase in the resources available to taxpayers to manage the increased burden. This has resulted in more output per unit of resource, because of which taxpayers are being stretched thin. This additional compliance burden, coupled with manual processes, has impacted taxpayers' efforts to maximise tax efficiencies while meeting compliance requirements. This confluence has highlighted the need for taxpayers to streamline, standardise and document their existing processes, while staying current with tax updates globally and constantly modifying their existing processes to accommodate new requirements.

Wingen: Without doubt, compliance requirements have increased significantly in the last couple of years due to an effort by jurisdictions to increase transparency and fight tax evasion and tax avoidance. This means that multinationals are confronted with a multitude of reporting requirements besides their regular annual tax returns like TP documentation, the European Union (EU) mandatory disclosure requirement for cross-border arrangements (DAC6) or CbCR. It is an inherent challenge for multinationals to collect consistent data to be able to fulfil these reporting requirements. However, the increased transparency created through these disclosure requirements deters multinationals from exploiting unjustified tax efficiencies where tax does not follow business.

FW: How have recent developments impacted the way organisations go about implementing their tax planning strategies?

Lagarden: Tax planning today is different from tax planning 10 years ago. The room to manoeuvre has become more limited for multinationals, driven by the move toward more tax transparency, for example an earlier and more comprehensive disclosure of intercompany transactions as reflected in Europe's Mandatory Disclosure Rules. Moreover, reputational pressure will be exercised on multinationals with a view to public CbCR in Europe from 2024/25. Therefore, some tax planning ideas will simply be discarded because they may be considered too risky. However, new opportunities for tax planning continue to be sought, as tax competition among countries persists and provides other opportunities, for example in M&A situations. In other instances, there is more consideration of the link between tax planning and the compliance burden when implementing certain measures. To be clear, 'tax planning' is not negative if we define it as pursuing opportunities provided by different domestic tax regulations to optimise a multinational's tax burden.

Orlandi: Overall, multinationals have substantially increased their efforts to comply with new regulations and tax laws. Moreover, transparency has become of paramount importance to demonstrate a multinational's commitment to corporate responsibility. Some of the main trends in this regard include implementing strong internal controls to ensure the organisation complies with all relevant tax laws and regulations, establishing clear policies and procedures for managing tax risk, including guidelines for identifying and mitigating potential risks, and for reporting and disclosing any material tax exposures, and regularly reviewing and updating TP policies to ensure they are appropriate and effective in the current environment.

Donnelly: I have seen organisations taking more time to consider the tax impact of making changes to their business, often due to navigating the increasing levels of anti-avoidance legislation coming into place. Where there are developments in tax cases, many organisations are keen to discuss how these may impact their current structures. There is a reluctance to try short-term schemes which then might need to be unravelled at a later date, causing additional cost and reputational damage if they prove undesirable. Consequently, there is a drive to move away from structuring with offshore vehicles and planning without adequate substance, and instead toward the use of onshore vehicles.

Odimma: Organisations have, in recent times, entered into partnerships with accounting firms to ensure they are up to date with legislative changes. We continue to see multinationals centralise their TP function, as this provides better visibility on the changes being made in their respective countries. Tax firms are able to update

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FTI Consulting

central TP teams on changes, and this helps facilitate faster system alterations where necessary. Furthermore, multinationals are leveraging technology for data collection, ensuring seamless integration among different accounting and business applications. This ensures organisations are agile and able to respond to changes in TP legislation at short notice.

Bhatia: Recent BEPS initiatives have introduced an additional lens through which taxpayers view their tax planning strategies. One example of this is that, in the past, R&D tax credits were always viewed favourably by taxpayers because they helped offset the tax expense and generally had a favourable impact on the effective tax rate. However, under the recent Pillar Two rules as part of BEPS 2.0, R&D tax credits are not always favourable anymore. Depending on the nature of the tax credit – qualified or non-qualified – it may result in additional tax liabilities for taxpayers.

Wingen: Recent developments in global tax, which have increased disclosure requirements to create transparency as well as reinforced the principle that profits should be taxed where the economic activity takes place, have led to less aggressive tax planning strategies by multinationals. The takeaway is that tax should follow business and any tax planning without commercial justification might not be sustainable. This has been reinforced by tax scandals like the Panama, Paradise and Pandora Papers in recent years, which have highlighted tax avoidance by multinationals and created awareness for potential reputational risks. Multilateral development banks have picked up on this development and now perform extensive tax due diligence on their clients to ensure they only lend to and invest in responsible taxpayers.

Armitage: Recent developments have narrowed the scope for TP-specific tax planning. Some companies, therefore, are staking out middle-of-the-road positions and seeking to ward off larger controversies by negotiating APAs. We have seen an increase in companies pursuing a global APA strategy, which typically includes an anchor APA between two or more large, predictable tax jurisdictions, followed by unilateral or bilateral APAs focused on regional hubs and using the anchor APA as a template.

Lash: Organisations are beginning to realise the importance of proper TP planning and risk management. Historically, many companies have chosen to allocate limited resources and attention to TP. However, with the recent international upswing in enforcement, discounting the importance of TP is no longer viable. Proper documentation and thorough TP analysis is the new minimum. Companies that want to stay ahead of the curve are beginning to look to other methods for risk management, including tax insurance. Tax insurance offers financial protection against TP adjustments, peace of mind to key decision makers and even tangible balance sheet benefits in the form of released reserves.

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>
> JEFFREY LASH
> Euclid Transactional

FW: Have you seen a noticeable increase in transfer pricing disputes between companies and tax authorities in recent times? What options are available to resolve such disputes as efficiently as possible?

Orlandi: There has certainly been an increase in TP disputes between taxpayers and tax authorities in recent times, as TP can be a complex and contentious area. On top of that, and as the OECD clarifies, "transfer pricing is not an exact science" and it is not uncommon that tax authorities have different opinions on how multinationals should allocate profits or losses among different jurisdictions. This can lead to TP disputes, which can be costly and time-consuming to resolve. To resolve them efficiently, multinationals should adopt a cooperative and transparent approach. On the other hand, tax administrations should use judgment in their evaluations and, most importantly, invest in the knowledge and development of their TP auditors. TP is a complex topic, and effective dispute resolution requires knowledgeable, skilled and committed operators on both sides. Other tools that can be used are those provided by the local and international legal framework, such as unilateral tax adjustments, MAPs and arbitrations, among others.

Wingen: TP has always been a highly disputed area resulting in many audits. The OECD MAP statistics show a consistent number of roughly 1000 new TP cases per year. This could be a good indicator

of TP audit intensity as a MAP, potentially with a subsequent arbitration, is the only way to resolve a cross-border double taxation after a TP audit. For taxpayers, however, it is advisable to engage in dispute prevention procedures to avoid lengthy TP audits and MAP procedures pursuing proactively an APA. Several countries also have domestic cooperative compliance programmes. For TP issues, these might unfortunately have limited value as TP relates always to cross-border transactions involving tax authorities from at least two countries. Better suited seem joint audits, where several tax authorities from different countries audit the same taxpayer transaction. An agreement in a joint audit would generally avoid double taxation.

> CONSIDERING THAT TP AUDITS MIGHT LAST MANY YEARS AND TOUCH SEVERAL COUNTRIES, IT IS IMPORTANT TO PROVIDE CONSISTENT DATA AND TELL A CONSISTENT NARRATIVE GLOBALLY.
>
> NORMAN WINGEN
> European Bank for Reconstruction & Development (ECRD)

Odimma: There has been a noticeable increase in TP disputes between companies and tax authorities. However, most of the issues are drawn out due to the inability of parties to reach a consensus. Meanwhile, some tax authorities do not conduct their own benchmark study but propose adjustments to some of the comparables used by taxpayers. This always leads to a long debate as the basis for including or excluding additional comparables is not always clear. Given that Africa has many countries with 'pay now, argue later' laws, the preferred option for resolving TP disputes is whatever does not incur a huge cash flow impact on the business, as the case may never be decided. It is always best to first ascertain if the issue in question is a one off or a recurring issue. For a recurring issue, it is important to identify judicial precedence. For issues that are a one off, it is always best to explore alternative dispute resolution mechanisms available under tax laws, for a quicker resolution.

Armitage: Virtually every major US Internal Revenue Service (IRS) audit starts, and often ends, with TP. Greater TP enforcement is an unavoidable outcome of IRS staffing decisions taken over the last decade and before. The Transfer Pricing Practice (TPP) – a dedicated, national TP audit function – is now 170 strong and maintains issue control over TP audits. If someone's only job is to audit TP, that is what they do, and the TPP can and does act independently of the main audit team, both in terms of its review processes and the audit timeline. Other countries undoubtedly have likewise expanded their dedicated TP audit functions. They often have much larger TP audit teams than the IRS, based on the overall volume of cross-border transactions.

Lash: Tax authorities worldwide, and in particular in the US, have ramped up TP enforcement. The IRS has been more successful in asserting TP adjustments, perhaps most notably in the recent case against Coca-Cola. The best way to resolve such disputes efficiently is to have properly prepared before the dispute arises. Rigorous TP analysis and thorough contemporaneous documentation are critical. We believe that proper preparation also includes obtaining adequate insurance, so that an unexpected resolution does not present a material threat to the company's balance sheet or, in the case of a public company, to its share price.

Bhatia: In general, as more tax authorities have levelled up their TP skillsets, this has resulted in additional tax audits and correspondingly an increase in disputes between companies and tax authorities. A good example of this is the recent increase in audits in countries like Germany and Switzerland in relation to financial transactions following the publication of OECD guidance on financial transactions. Other common themes for TP audits include management services charges, a routine entity making losses, and recharacterisation of sales and marketing entities to distributors. Taxpayers can proactively get certainty on their TP policy by engaging in unilateral or bilateral APAs. MAP is a practical instrument to get relief from double taxation should taxpayers have an unfavourable outcome from a tax audit.

Donnelly: Most tax audits now include TP. In 2020/21, HMRC's revenues from TP were the highest in history at £2.16bn and its profit diversion compliance facility continues to target MNEs with 17 new registrations and 22 cases resolved in 2020/21. Tax authorities are becoming much more strategic in the areas of tax and TP, and the businesses they focus on. They are aware they have limited resources so need to be efficient in using them where there is the greatest payback. Additionally, tax authorities are becoming bolder in starting audits in certain industries where historically they have focused less, such as in financial services where specialist knowledge is required. There tends to be less efficiency in audits that take a long time as staffing on both sides can change and information gets forgotten. Where

possible, the best way to tackle an audit is to keep the momentum going in order to get it resolved quickly. Regular discussions ensure that progress can be made and the audit stays on track.

Lagarden: After a certain slowdown due to the pandemic in 2020/21, which led to delayed ongoing audit processes as both taxpayers and tax authorities needed to adapt to the then new situation, this 'interim period' is obviously over now. However, based on my experience, tax authorities in certain countries worked in a very constructive and pragmatic manner to keep audit proceedings and mutual exchange with the taxpayer afloat, despite recurring lockdown situations. My expectation is that audits will become more detailed and aggressive going forward, given clear national budget financing needs in many countries where the pandemic has drained state funds considerably. In this context, to more efficiently resolve disputes, engage in an early, cooperative dialogue with fiscal authorities, and employ joint audits rather than the usual unilateral audit approach, tax rulings, MAP or APAs.

FW: If a company finds itself subject to a tax audit or investigation, what advice would you offer on how it should respond?

Bhatia: In a tax audit situation, first and foremost engage with tax authorities and try to understand their viewpoint. Taxpayers should have an open discussion with tax authorities and proactively educate them on the company's products and business models and put their best arguments forward to support the tax position. If the engagement does not result in a favourable outcome, litigation is an option, albeit an expensive one, and can take years to reach a resolution. Getting competent authority relief through a MAP is an excellent alternative, but this can take between 24 and 48 months to resolve.

Odimma: If a company is subject to a tax audit or investigation, the first step is to be transparent and fully disclose all relevant transactions. It is also important to provide a proper description of the company's business and value chains. Once notification of the audit is received, the taxpayer should proactively collate all relevant information and documents necessary for the audit. This shows the company is transparent and willing to cooperate with tax officers, and should foster mutual professional respect. A tax firm may also be engaged to assist with the audit. It is always important to ensure the draft findings are discussed with the field team to provide any clarification before the assessment.

Lash: Taxpayers should cooperate fully and completely with reasonable, in-scope requests from a tax authority. Assuming that the taxpayer's position is supported by reasoned analysis and documentation, the best way to help the tax authority understand and get comfortable with the position is by being transparent and forthcoming. If auditors feel like a company is hiding the ball, they have every incentive to assess first and ask questions later. This can also damage a company's reputation with the tax authority, leading to additional attention or enforcement efforts. One advantage of tax insurance is that it covers the risk of assessment, eliminating any potential incentive, however misguided, to be overly combative with the tax authority.

Armitage: In the US, companies should act immediately upon the start of an IRS audit to defend their TP. They may want to disclose voluntarily self-initiated adjustments and must produce their TP documentation within 30 days of a request. More broadly, TP positions are seldom without merit and should be defended unless clearly wrong. IRS agents respond reasonably to reasonable arguments, respectfully presented. Where the IRS demonstrates that a position faces risk, it is possible to reach agreement with the audit team on an appropriate approach. It may be helpful, or necessary to avoid double tax, to involve the US competent authority in a unilateral or bilateral APA if the audit becomes intractable. Taxpayers should identify strong TP counsel, before audit, who can advise on these decisions, both in the home country and in other important countries.

Donnelly: It is important to understand upfront the tax authority's area of concern and seek clarification from the tax authority if unclear. Many audits start with long information requests which can be time consuming for companies to collate, and in the end some of it may be irrelevant. It is also important to ensure that the tax authority understands the business

> IN TODAY'S LANDSCAPE, IT IS VERY IMPORTANT THAT TAXPAYERS REGULARLY REVIEW AND UPDATE THEIR TP PROCESSES TO ENSURE THAT THE IMPACT OF ANY NEW TAX DEVELOPMENTS GLOBALLY IS CAPTURED BY EXISTING PROCESSES.
>
> ABHIJAY BHATIA
> Convatec Group PLC

and supply chain and that companies have considered whether to take advice in order to focus the audit. It is often the case that where a company has started to respond itself, that the audit has widened as the information that has been provided leads to further questions. Some of the best outcomes are when the company has taken the lead on fact gathering and correspondence, but with the support and direction of advisers. Remember that advisers are then in a position to help with any end negotiations too.

> RECENT DEVELOPMENTS HAVE NARROWED THE SCOPE FOR TP-SPECIFIC TAX PLANNING. SOME COMPANIES, THEREFORE, ARE STAKING OUT MIDDLE-OF-THE-ROAD POSITIONS AND SEEKING TO WARD OFF LARGER CONTROVERSIES BY NEGOTIATING APAS.
>
> J. CLARK ARMITAGE
> Caplin & Drysdale Attorneys

Lagarden: My advice is to maintain structured and regular communication with tax authorities. This may include a regular exchange, such as physical meetings, or the taxpayer providing a joint database for the tax authority to use, to streamline audit queries and document provision, and to create and archive reports and final findings regarding individual audit questions. It is important for taxpayers to remain cooperative and respectful toward fiscal authorities, despite sometimes challenging discussions in an audit situation. However, given the fact that companies usually do business in a country over decades, it clearly pays off to establish a sustainable, trust-based, long-term cooperative relationship with local tax authorities, whether in an audit situation or beyond. Engaging in horizontal monitoring programmes or comparable domestic compliance initiatives are useful steps in this regard which companies should definitely consider.

Wingen: Multinationals should of course be cooperative and transparent. Given that TP is such a fact-based area, significant time should be invested in explaining the specific business model and TP structure during the tax audit. Bringing in business representatives, rather than the tax department, to make explanations might introduce a more neutral perspective in the discussions. Finally, considering that TP audits might last many years and touch several countries, it is important to provide consistent data and tell a consistent narrative globally.

Orlandi: A company should adopt a cooperative and transparent approach to a tax audit or investigation. On top of that, and considering that tax, and especially TP documentation, are not often considered by tax authorities exhaustively, the advice would be to start gathering and organising relevant documentation that will likely be requested at a later stage of the audit. In this regard, it will be particularly important to explain the business model and the value chain related to the transactions under analysis. Such documentation should be gathered and organised in a timely and orderly manner. If a multinational is unable to resolve any issues with tax authorities through normal channels, it may be possible to use alternative dispute resolution mechanisms, such as MAPs and arbitration. Finally, if the audit reveals any issues with the company's TP policies or procedures, it is important to review and update these as necessary to ensure compliance in the future. Possibly, an APA, based on the findings of the audit, may be required.

FW: How important is it for companies to regularly review and update their transfer pricing processes? What considerations should they make when doing so?

Odimma: Companies are advised to regularly review their TP processes and documentation to ensure policies align with practice. A health check review of TP polices is a great way to ensure uniformity of strategy, policies and approaches to TP disputes. A culture of continuously reviewing TP polices is a must for any company that intends to be proactive in managing its TP disputes. It is important to periodically visit subsidiaries to ascertain whether business arrangements as envisaged in the TP files are consistent with actual business practices.

Lash: It is crucial that companies regularly review and update TP processes to ensure that they remain in compliance. Even if a company's controlled transactions remain materially unchanged, external developments may necessitate updates to the group's TP. For example, companies must stay abreast of new developments and guidance from the OECD and local country tax authorities. Companies also need to consider how changes to the macroeconomic environment may affect TP targets, as well as actual realised results, and must routinely revisit comparables analysis as new data become available.

Donnelly: Businesses are continually evolving, so it is likely that their TP transactions and processes will become out of date unless regularly reviewed and updated. The cost of overlooking proper TP implementation and documentation

can be adjustments in TP audits, resulting in additional tax liabilities, interest and penalties on tax underpayments, and the potential for double taxation or even overpayment of tax on incorrect transactions. Therefore, it is usually more cost effective to update the documentation and processes at least on an annual basis. Various considerations include, but are not limited to, the following. First, ensuring that changes in the business are reflected in the updated documentation, such as where there were restructurings. Second, assessing whether there are any new transactions. Third, addressing any additional TP compliance requirements which have been brought in any jurisdiction. Fourth, updating pricing, especially on financial transactions where the organisation might be subject to external debt on a floating rate. Fifth, considering whether any of the supporting documentation, such as benchmarking, ought to be refreshed. Sixth, assessing whether the policies still appropriately reflect the transactions within the organisation. And finally, checking that TP policies continue to be implemented correctly.

Lagarden: It is an ongoing task for any company to adapt its TP system to changing internal or external framework conditions. As an example, changes in internal accounting and reporting systems, which provide the data source for price setting and documentation, may require the review or reconstruction of quantitative information gathering and utilisation for TP purposes. Moreover, established processes like documentation or operational TP should be reconsidered with a view to exploit opportunities for automation and implementation of IT tools to free up time for more conceptual TP development work. The introduction of new business models may require tailored TP processes or adjusting established ones. All this needs to be done with a view to enhance efficiencies to deal with an ever-growing TP compliance workload for multinationals going forward.

Armitage: Many companies have little choice when it comes to reviewing and updating their TP. They may be under constant TP audit in one or more jurisdictions or may have wide coverage of TP through documentation that is reviewed and perhaps updated annually. For companies with a smaller US footprint, they should at least have a TP plan that details what their TP is and why, or, if they operate through a branch, a plan for determining their US effectively connected income. While such plans may not offer protection from TP and other valuation-related penalties, they reduce the likelihood that the company will be out of compliance and provide a ready response to an IRS auditor that takes an interest in whether TP has been used to reduce artificially US profits.

Orlandi: It is important for multinationals to regularly review and update their TP processes to ensure compliance with TP rules and to minimise the risk of disputes with tax authorities. The main factors to be considered when conducting such a review are material changes in the business environment, especially with regard to the company's business model or supply chain, and changes in tax laws and guidance to ensure that the company's TP policies and procedures are in line with the latest rules and guidance. It is generally recommended that companies review their TP processes at least annually, or more frequently if there have been significant changes to the business or regulatory environment.

Bhatia: In today's landscape, it is very important that taxpayers regularly review and update their TP processes to ensure that the impact of any new tax developments globally is captured by existing processes. Additionally, it is important that taxpayers revisit their TP processes to ensure there are appropriate controls built in, which would give them confidence that the output of these processes can be relied upon. It is also important that taxpayers revisit their processes from time to time in light of availability of new automation tools that would help with streamlining and standardising processes, especially in a resource-constrained environment. ■

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