ERNST & YOUNG

News release

Donna Liew
Ernst & Young Solutions LLP
+65 6309 6129
donna.liew@sg.ey.com

Growing transfer pricing scrutiny by world's tax authorities demands focus on anticipating undisclosed risks for multinationals

Global recession pushing tax authorities to intensify enforcement and compliance

SINGAPORE, 29 SEPTEMBER 2009 - Multinationals are facing new tax risks due to a growing number of authorities adopting divergent transfer pricing (TP) requirements, according to a new Ernst & Young survey examining the approaches and attitudes of tax authorities in 49 countries.

The *2009 Global Transfer Pricing Survey* comprises insights from Ernst & Young's TP professionals around the world and interviews with tax authorities. It reveals a dramatic increase in the scope of TP documentation demanded by governments and their stated intent to seek penalties more frequently and at higher levels when multinationals get it wrong.

Since Ernst & Young's last TP survey of tax authorities in 2006, more than 10 additional jurisdictions have introduced new requirements for tax payers to create and maintain documentation arrangements, with China, Slovakia and Greece the three most recent.

Luis Coronado, Transfer Pricing Leader for Ernst & Young in the Far East, says: "Amid the challenges of a global economic downturn, many governments are sharpening their focus on compliance, enforcement and legislative approaches. While TP regulations were once confined to a handful of industrialized countries, they have since spread rapidly beyond OECD (Organization for Economic Cooperation and Development) membership. As governments search for tax revenues to offset growing budget deficits and financing stimulus, multinationals will have to be prepared for self-assessment and more TP investigations. In order to mitigate being selected for audit, multinationals will need to adopt a hands-on management approach to TP design as well as making sure they follow best practices in documenting TP decisions.”

“In Singapore, transfer pricing is a relatively new area of focus. The Inland Revenue Authority of Singapore has issued the Singapore Transfer Pricing Guidelines since 2006 and uses the Transfer Pricing Consultation to monitor and ascertain the level of compliance in Singapore for transfer pricing. Tax-paying companies operating in Singapore can stand guided by the typical triggers for transfer pricing seen in other countries. These include the profitability of the local taxpayer, the volume of related-party transactions, and whether the taxpayer has appropriately assessed and documented its transfer pricing risks,” Coronado adds.

Tax authorities dedicating more resources to TP investigations

Given the need for governments to raise revenues in the challenging economic climate and the changing regulatory environment, the study anticipates heightened litigation in the near future. This expectation is driven by the almost universal trend towards increased TP investigation resources within tax authorities.

Countries that are relative new comers to TP enforcements are tending to gear up capabilities quickly. Finland, with a team of approximately 45 experts involved in TP with regulations in place for only two years, is an example of this trend. Furthermore, a number of jurisdictions are moving towards setting up specialist transfer pricing examination teams (e.g., Austria, Indonesia and Slovenia), with the aim of focusing their efforts and resources.

Growing divergence of views among tax authorities

There is a growing divergence of views among tax authorities about what TP should encompass. Most countries follow the OECD guidelines, but local implementation can vary significantly. Sometimes these variations lead to situations in which the tax authorities of the two countries involved come to quite different conclusions about the correct pricing and bilateral approaches needed to resolve the matter.

Coronado explains: “Organizations operating internationally are discovering that their TP positions may face challenges from one authority, even when that position is well supported and accepted by other tax authorities operating under the umbrella of the OECD guidelines.”

Industries, countries and transactions in the spotlight

In roughly half of the countries surveyed, certain industries are formally or informally being targeted. Sixteen tax authorities stated that they target specific industries and eight more are believed to do so out of the 49 this survey covers. The main targeted industries are automotive, consumer products, financial services, oil and gas, and pharmaceuticals.

The survey also revealed that a clear focus is emerging on transactions with perceived tax havens and "blacklisted" countries. Authorities are also more likely to consider a broader range of company transactions that can result in more detailed investigations, particularly in the non-tangible spectrum such as financing and services.

Scenarios that signal further TP investigation include unusually high profits or losses in a group company; corporate restructurings involving closures or reductions in operations; significant inter-company management fees; dealings with a group company in a tax haven; and being located in a low-cost country.

As a result of the global financial crisis, shifting economic conditions have made managing TP issues more difficult for tax directors of late, as many of the factors that influence the TP decision-making process are constantly in flux. These shifts in the economic environment are, in some cases, providing a trigger for a transfer pricing audit, adding another layer of complexity for the tax function.

Managing the risks

Since every cross-border intra-company transaction potentially requires dealing with at least two different tax authorities, each of which may look at the same transaction twice, it is almost impossible to eliminate TP risk entirely (unless the transactions are covered by an Advance Pricing Arrangement "APA"). However, this can be mitigated by exercising good risk management principles. For instance, if an organization has a good working relationship with their local tax inspector, documentation can provide a basis for reaching a mutually agreeable settlement of the issues.

The survey also indicated that globally an increase in the usage of APAs is occurring, in an effort to give both the taxing authority and the multinational an increased level of certainty in an uncertain world. An APA is an agreement between a tax authority and a multinational company about the determination of the appropriate transfer pricing method to be used for pricing inter-company transactions. APAs may be unilateral, bilateral (two governments) or multilateral (three or more governments).

“Singapore has a detailed formal APA program since 2006 and supplementary guidelines of 2008. With transfer pricing gaining prominence worldwide, we expect requests for APAs to rise” says Coronado. “Singapore also has a very vast network of tax treaties, which ultimately provides for Mutual Agreement Procedures (MAP) that can be resorted to in minimizing double tax issues.”

Planning for the future

The continued and growing interest of tax authorities in TP and the proliferation of local rules have made the assessment and management of TP risk a key focus for CFOs and tax directors. Multinationals should have in place effective tools for identifying and measuring risk and a familiarity with both technical and procedural approaches for dealing with TP issues raised by tax authorities.

Coronado concludes: “Our survey demonstrates that there has been a wave of transfer pricing rules and regulations internationally over the last few years. In addition, there have been high-profile court cases and the deployment of a considerable amount of transfer pricing enforcement among local tax authorities. Not surprisingly, tax directors all over the world see transfer pricing as the most important tax issue facing their company today. Potential undisclosed liabilities on transfer pricing affairs need to be addressed in a proactive matter as many countries are shifting the burden of proof on arm’s length pricing to taxpayers.”

“Transfer pricing is most of the time so intertwined with the operation of the company that it cannot be addressed in isolation. It goes to the heart of any multinational company with intercompany transactions. Therefore, a systematic, centrally managed and structured approach is key. Ultimately, TP needs to be an integral part of any multinationals’ business model.”

ends-

About the survey

Ernst & Young's *2009 Global Transfer Pricing Survey* is based on contributions from the firm's transfer pricing leaders around the world during April / May 2009. Where tax authorities were prepared formally to discuss their approaches with us, interviews were held with those authorities. The survey will be available in its full form at www.ey.com/tpsurvey

About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 135,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

For more information, please visit www.ey.com.