2016-17 Transfer Pricing Survey Series

Operationalizing global transfer pricing

Key steps for translating strategy into practice

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This report is the fourth in a series about the global 2016-17 Transfer Pricing Survey conducted by EY. To receive other reports in the series, please visit **ey.com/tpsurvey** or connect with your local EY Tax contact.

Contents

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– Peter Griffin
EY Global and Americas Transfer Pricing Leader

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2016–17 EY Transfer Pricing Survey Series

In this final installment of our 2016-17 Transfer Pricing Survey, we examine the work needed to respond to the seismic shifts taking place in the world of global taxation. Below we examine the findings of what 623 respondents in 36 jurisdictions across 17 industries have to say regarding forging a practical response to so much change — or as this report refers to such matters, operationalizing.

Prioritizing actions

For tax and transfer pricing, it is an era of transformation. As earlier installments have shown, transparency is now the watchword, with tax authorities now having access to more data than ever before. Meanwhile, new laws based on recommendations to curtail base erosion and profit shifting (BEPS) from the Organisation for Economic Co-operation and Development (OECD) are being written or legislated and enacted at a blistering pace. Put it all together and the likelihood and scale of controversy, and the level of resource required to address this, has only one place to go — higher.

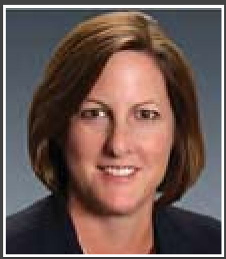
So there's much to attend to in order to tighten the internal position. In terms of prioritization, the key areas of focus identified by respondents include:

- **Establish a clear vision and strategy**

  Both the survey and anecdotal evidence point to the overwhelming importance of adopting a strategic approach to all that is happening. As EY Global and Americas Transfer Pricing Leader Peter Griffin explains, "Over the past few years, companies have done a better job analyzing how transfer pricing affects their operations. But the levels of transparency and scrutiny that are just taking hold today are much more intense than what we've seen in the past." Consequently, says Griffin, "it really is time to take a step back to look at everything from a global perspective — the same perspectives are becoming available to tax authorities in every jurisdiction where you do business." The total picture, says Griffin, "has to tell a consistent global story, and that requires absolutely clear strategic vision of what the transfer pricing objectives are and how to achieve them."

- **Evaluate and ensure data quality/accuracy**

  More than a third of executives, 37%, say their future work will include an intensive focus on making sure that data used for decision-making and provided to tax authorities is indeed accurate and reliable. "Generating data and outputs that drag results from your systems reflective of the intended policies has cross-purpose benefits," says Robbert Kaufman, EY Americas Transfer Pricing Market Leader. It gives comfort to both internal users for decision-making regarding resource allocation, key business decisions and performance reviews, whilst also to tax authorities in the event of an enquiry or audit, so they are comfortable that the outputs reflect the intended policy."



"Developing a comprehensive, globally consistent and yet tax-efficient transfer pricing strategy is a tall order. It requires someone who not only understands today's tax environment, but who also has intimate knowledge of a company's global operations, future investment and growth strategies, and traditional transfer pricing practices."

– Anne Welsh
US West Region Transfer Pricing Leader

- **Integrate more closely with business operations**

  Next up on the "to do" list for 34% of companies is building closer coordination between tax and business units. The fact is, amid so much change, says Ronald van den Brekel, EY Global Head of Transfer Pricing Technology, companies have actually been handed somewhat of an operational opportunity, in particular from the OECD's focus on development, enhancement, maintenance, protection and exploitation of intangibles (DEMPE) functions and business alignment. "The need to align tax and the business models is critical – tax authorities are already questioning and seeking to understand the alignment as a starting point of inquiries, audits or from proactive discussions." "It's not only just so many changes to the rules," says van den Brekel, "but companies should also be taking a look at the impacts from all the advances in technology." Closer integration, says van den Brekel, "presents an opportunity to not only make better core strategic choices, but also to streamline operations."

- **Update policies/procedures/processes**

  Another key priority for nearly a third of businesses, 32%, will be taking a fresh look at fundamental, day-to-day procedures. Again, companies will not only be seeking to align policies/procedures/processes to a wide range of new realities; they will also be seeking to automate, streamline and, wherever possible, improve efficiency and accuracy, and optimize information for decision-making.

Recognizing the shortcomings

All told, "meeting the competing priorities is no small set of challenges," says Griffin, "but as reflected in the closeness of many of the priorities, there's really nothing on the list that any company can afford to overlook." Consequently, says Griffin, "companies need to, right now, do a realistic assessment of what needs to be done and whether or not they have the resources."

Here, businesses have more work to do. Having measured the prioritization of the above set of actions, the survey next asked companies for a self-assessment of their maturity/capability in each area. And for most areas that today require attention, there is a significant shortage of those describing their maturity/capability as high (as opposed to medium or low).

Moreover, this capability versus operationalization needs gap is by far the largest for the number one most frequently cited priority: developing a clear vision and strategy. As Anne Welsh, US West Region Transfer Pricing Leader, explains, "Developing a comprehensive, globally consistent and yet tax-efficient transfer pricing strategy is a tall order. It requires someone who not only understands today's tax environment, but who also has intimate knowledge of a company's global operations, future investment and growth strategies, and traditional transfer pricing practices." But while 69% cite this area as a key priority, only 35% rate themselves highly, creating a 34% maturity/capability gap. Small wonder, says Colleen Warner, US Central Region Transfer Pricing Leader," so few companies actually have the resources they need to perform this essential strategic exercise." As discussed in our first report in this series, only 21% of respondents have aligned their internal resources with their most important regions, while 10% are similarly aligned with their external resources (with 26% aligned both internally and externally).

The news improves little as the survey continues. For the number two priority, evaluate/optimize data quality/accuracy, the maturity/capability gap is a hefty 19%. A look at the next two listed priorities, integration with business operations and update/review policies/procedures/processes, generates gaps of 20% and 13%, respectively. All told, says Warner, "companies need to take a hard look at their resources to make certain they're addressing these key priorities capably." Failure to do so, says Welsh, "increases both the likelihood and potential severity of tax risks down the line, and reduces the ability of existing resources to focus on higher-value-adding activities."

Company needs exceed their grasp

	Top transfer pricing priorities	Maturity or capability	Gap
Clear vision and strategy	69%	35%	34%
Data quality and accuracy	37%	18%	19%
Integration with business operations	34%	14%	20%
Policies, procedures and processes	32%	19%	13%
Cross-functional teamwork	23%	19%	4%
Technology enablement and automation	23%	9%	14%
Governance roles	22%	22%	0%
Skills/capabilities/ training	14%	13%	1%

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US Central Region Transfer Pricing Leader

"Companies need to re-evaluate the things that can be done to automate key tax and transfer pricing activities — there have been tremendous advances in technology that can be harnessed. This will mitigate the risk from getting things wrong, provide comfort to users, and reduce the time and effort to correct and potentially explain variances to tax authorities."

— Robbert Kaufman
EY Americas Transfer Pricing Market Leader

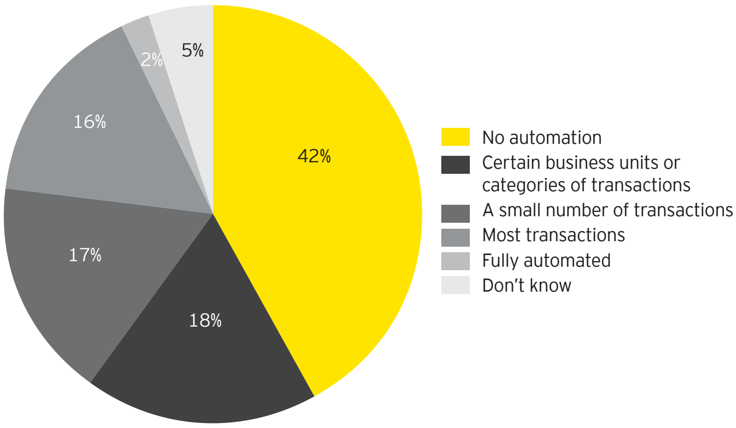
Other key inhibitors

One can track the sense of lacking the needed maturity/capability to a number of shortcomings and challenges that are common in global tax functions. Asked to note whether or not their firms were experiencing a range of key operational challenges, nearly half (49%) indicated that, indeed, their transfer pricing function still suffers from a high degree of manual processing.

In just one example, only 18% of executives describe their true-up processes for intercompany transactions/allocations as consistently/widely automated: that is, 2% describe processes as fully automated and 16% say most transactions are automated. From there, 18% say they are automated for certain business units or categories of transactions and 17% are automated for a small number of transactions. Forty-two percent report no automation or, in other words, their true-up processes are fully manual.

"True-ups," like so many global tax processes, are primarily manually performed and done on an inconsistent basis

How automated are your true-up processes on intercompany transactions/allocations?



Putting matters in perspective, says Kaufman, "companies need to re-evaluate the things that can be done to automate key tax and transfer pricing activities — there have been tremendous advances in technology that can be harnessed. This will mitigate the risk from getting things wrong, provide comfort to users, and reduce the time and effort to correct and potentially explain variances to tax authorities."

Next on the list, 44% of transfer pricing professionals say that developing/maintaining documentation of global transfer pricing arrangements represents a significant challenge for their organization. Indeed, as earlier reports in this series have indicated, only 21% maintain full compliance with today's documentation requirements (with 44% aiming to do so only in high-risk situations).

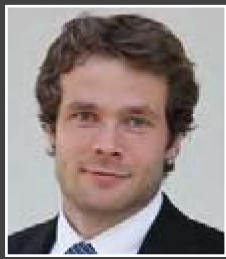
Other frequently cited inhibitors include an inconsistency of processes or methods across the organization (40%), difficulties in implementing policies (32%) and, somewhat concerning, a lack of alignment with the business operating model (28%).

A range of operational issues create significant challenges for global transfer pricing

Degree of manual activity/lack of automation	49%
Challenges in developing/maintaining documentation	44%
Inconsistency of processes or methods across the organization	40%
Implementation of policy	32%
Lack of alignment with the business operating model	28%
Lack of time during the financial close	27%
Inadequate monitoring controls	26%
Inability to determine (true-up) actual profits in certain countries	21%
Complications relating to foreign exchange	18%
Lack of alignment between customs valuation and transfer pricing (end-of-year adjustments)	12%

Finally, in what might be a highly illustrative finding, only slightly more than half (52%) of companies monitor their financial results to ensure compliance with transfer pricing at least quarterly (38%), or monthly (11%), or go so far as to have a look in real-time (3%). More concerning, a full third (35%) review such results only once a year. Meanwhile, 13% either don't conduct any form of transfer pricing reconciliation/evaluation (9%) or describe the frequency as "other" (4%).

The problem here, says Sveinung Baumann-Larsen, EY EMEIA Transfer Pricing Market Leader, "is that firms may not be identifying problems and taking needed actions in time to make necessary corrections." This could result not only in compliance problems, but it also reduces opportunities "to make operating adjustments during the course of the year that could better optimize after-tax outcomes while maintaining full compliance and reducing the risk profile."



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How businesses should respond

Focusing not only on operationalization, but on the whole of transfer pricing, companies need to:

1 Reassess and define their core transfer pricing strategy

Recognize that — in an era of country-by-country (CbC) reports, master files and information sharing and generally greater transparency, tax authorities will no longer rely on local assessments only. Consequently, companies must make absolutely certain that their strategies, policies, practices and actual transfer prices are clear, consistently applied and can stand up to intensive scrutiny.

2 Align transfer pricing strategies and documentation with BEPS principles

As anti-BEPS principles take ever-firmer hold, companies will need to update their business structures and ultimately their transfer pricing framework and documentation. Failure to do so will increase the likelihood and cost of controversy and potential damage to reputation.

3 Assess and prioritize your needs

Take the time to assess your needs and where risks might arise, how you are placed to effectively respond to them and develop steps to narrow the gaps.

4

Re-evaluate resources

Do you have the skills/abilities/resources necessary to accomplish everything associated with heightened transparency, BEPS and an overall likelihood of accelerating controversy? As the survey shows — most organizations are by no means adequately equipped to address the needed workflows and specializations required.

5

Harness automation

One means of addressing the resource shortfall is embracing technology. Leading companies are able to automate many of today's manual processes, freeing resources for the wide range of tasks (often strategic or value adding) on the tax department "to-do" list.

6

Be proactive

Once strategies are formed, policies implemented and processes put in place, companies will be in a better position to assess their greatest tax risks. Where possible, consider such steps as looking for an advanced ruling or negotiating an advance pricing agreement (APA).

While the above list is by no means comprehensive, it begins to highlight just how much work is needed to achieve compliance and operational optimization within a global transfer pricing framework.

Conclusion

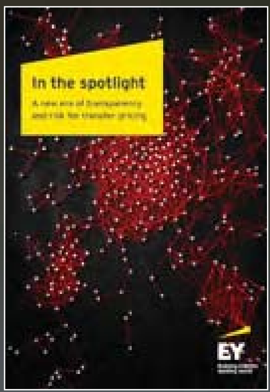
Operationalization is where theory and strategy must be translated into practice.

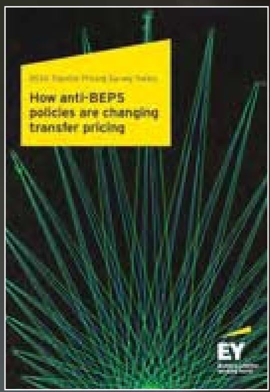
At the beginning of this 2016-17 Transfer Pricing Survey Series, we established string art as a metaphor for the current transfer pricing environment. The elaborate patterns of string art mimic the elaborate supply chains that make globalization work today. Taut and colorful, string art can produce beautiful pictures. But if a thread frays or a pin comes loose, the image can unravel.

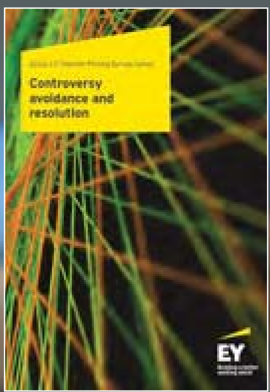
Good operationalization is like the maintenance needed to preserve a masterpiece. The entire universe of transfer pricing is in a state of profound change.

Add to this the challenges explored in this report — and in the broader series — and it becomes clear that businesses need to take a closer look to ensure their organizations have the required capabilities to execute against all of their transfer pricing objectives and compliance requirements.

Transfer Pricing Survey Series







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EY Transfer Pricing contacts

Peter Griffin
EY Global and Americas Transfer Pricing Leader
+1 612 371 6932
peter.griffin@ey.com

Curt B. Kinsky
EY Asia-Pacific Area Leader — Transfer Pricing
+852 2629 3098
curt.kinsky@hk.ey.com

Oliver Wehnert
EY EMEIA Leader — Transfer Pricing
+49 211 9352 10627
oliver.wehnert@de.ey.com

Ichiro Suto
EY Japan Leader — Transfer Pricing
+813 3506 2411
ichiro.suto@jp.ey.com

David Canale
EY Global and Americas Transfer Pricing Controversy Leader
+1 202 327 7653
david.canale@ey.com

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