

ROUNDTABLE

Transfer pricing

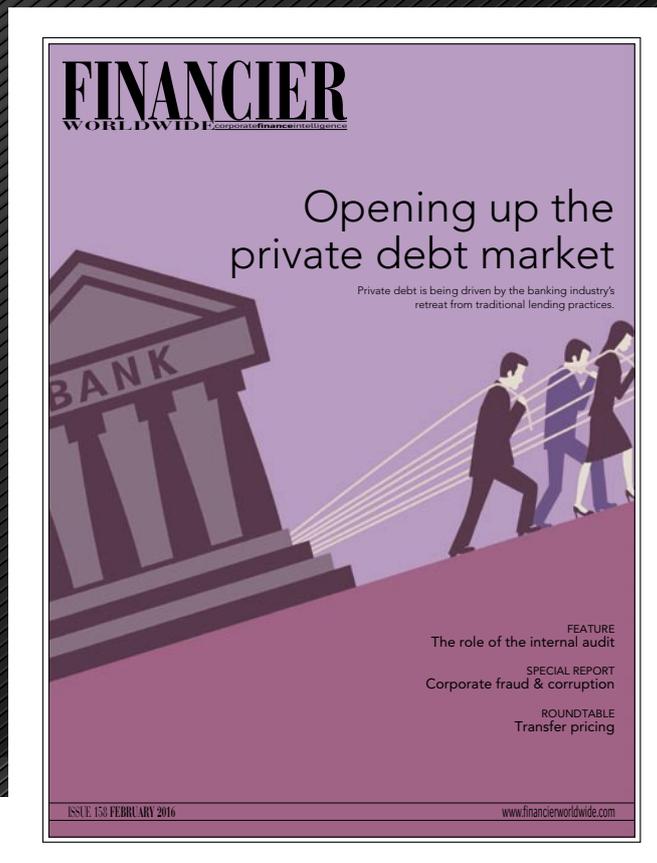
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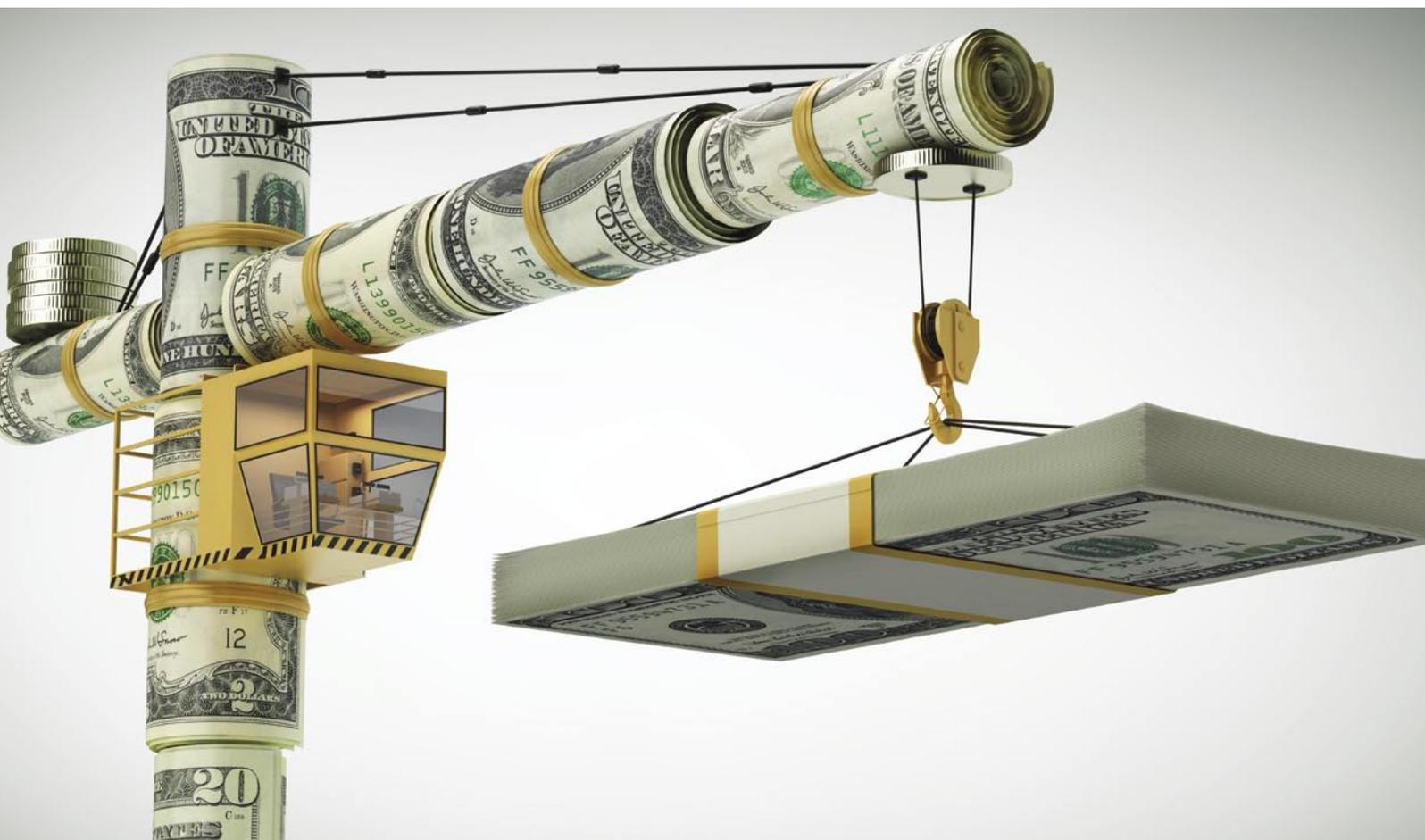
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R O U N D T A B L E



TRANSFER PRICING

Transfer pricing is one of the most important issues currently tasking international tax authorities, with the last 12 months seeing some of the most significant developments in this arena for over a decade. Across the globe, governments are becoming stricter in how they deal with transfer pricing violations and audits are increasing in sophistication. With an estimated 60 percent of international trade taking place within, as opposed to between, multinationals, the issues surrounding transfer pricing are set to continue. ▶▶

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FW: Could you provide an overview of the most significant developments in the transfer pricing landscape over the last 12 months or so? How have these developments impacted upon organisations and how they approach tax planning?

Curd: There were three significant regulatory issues that permeated the transfer pricing landscape for multinational companies in 2015: Base Erosion and Profit Shifting (BEPS), Country-by-Country Reporting (CbCR), and the Altera tax court case. In addition to regulatory issues, the public outcry has increased against what is perceived as evil multinationals cheating people out of money through transfer pricing. The work that the OECD continues to do through BEPS Action Plans will certainly impact all multinationals small and large, while the CbCR is currently targeting the largest companies. Both BEPS and CbCR are leading to a higher level of documentation and compliance.

Greinert: The most significant development in transfer pricing is the finalisation of the OECD's BEPS project. The project has led to significant changes in the existing OECD transfer pricing guidelines which are the main source of interpretation of the arm's length principle. These amendments relate not only to specific types of transactions, such as intercompany transactions involving intangibles or services, but also to the overall transfer pricing system and transfer pricing documentation requirements. Germany is currently working on implementing these new rules into domestic legislation. Multinationals are now reviewing their transfer pricing policies in view of the new OECD position and, in our experience, becoming more prudent in their tax planning.

Gracia: At an international level, clearly the most significant developments arise from the BEPS Project, Actions 8-10 amending the OECD Guidelines and, above all, Action 13 on the introduction of the CbCR for the largest multinationals but setting a precedent which might give rise to further developments at national or regional level covering a wider scope of companies or to public disclosure. From the Spanish perspective, Spain has been the first country in the world to incorporate into its legislation the CbCR obligations, taking advantage of the approval of a new corporate income tax law back in 2014 which has been developed by way of regulations over 2015.

Gaspar: Multinationals have been monitoring the BEPS initiatives for the past few years and there are few differences between the initiative and how transfer pricing is done in Brazil. The outcome to Actions 8-10 were published in 2015 but still it is hard to understand if and how it will impact Brazil given the fact that Brazil is not an OECD country and that the local fixed margins practices differ materially from it. Nevertheless, over the years Brazil has come closer to ALS in some aspects and I can now see some connection between Brazil's current PCI/Pecex methods and OECD's CUP, especially when it comes to commodities. Other relevant changes in the country refer to the enhancement of the aforementioned PCI/Pecex methods with additional adjustments brought by rulings IN RFB 1.458/2014 and 1.568/2015, bringing them even closer to independent comparable.

Schwarte: The most significant transfer pricing development that took place in the last 12 months is without a doubt the deliverance of the final BEPS transfer pricing deliverables in October 2015. The transfer pricing deliverables can, and will, significantly increase the compliance burden for many multinational entities. With respect to the Netherlands, this has led to an obligation for

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companies with global revenue of €50m or more to have an annually updated transfer pricing master and local file in place. Of course, CbCR, which will be required for companies with global consolidated revenue of €750m or more, will also increase the compliance burden greatly.

Secular: The BEPS project and the issue of draft guidelines, if enacted, will change the transfer pricing landscape. The BEPS project, which is supported by the G20, will introduce many changes, the two most significant of which will be amendments to the documentation requirements, by means of CbCR and the need for multinationals to provide details of all of their transactions in every country in which they operate; and the definition of a Permanent Establishment (PE) to include commissionaire arrangements and undisclosed principles.

Carden: 2015 brought some of the most significant transfer pricing developments in the last decade, both in the US and globally. On the US front, there were significant events in both the litigation and regulatory contexts. The US Tax Court unanimously invalidated regulations that previously required participants in a cost sharing agreement governed by US transfer pricing rules to share stock-based compensation as part of the arrangement. While this decision remains subject to appellate court review, it is an important indication of the courts' independent application of the arm's length standard and refusal to simply defer to the IRS' and US Treasury's approach to transfer pricing enforcement.

Musselli: The most important developments in the transfer pricing area come from OECD and the BEPS project. As everybody knows, the project adopts a 15-point action and several governments are going to adopt the new OECD instructions.

FW: What indications are there that governments are ramping up their transfer pricing enforcement efforts? Are more resources being allocated to this area?

Greinert: German tax auditors are more and more skilled in auditing transfer pricing cases and have built up significant experience and know-how in this area. We see a strong increase in cases which are audited both from a regular tax auditor as well as from a tax auditor specialised in transfer pricing. In addition, there have ►

been several state aid cases in the EU with respect to transfer pricing which show that there are increased efforts by governments and the EU to enforce transfer pricing regulations.

Secular: The UK and Australian tax authorities have already introduced CbCR legislation and other jurisdictions are expected to follow suit soon. The UK tax authorities also issued the DPT in 2015, and once the OECD issues the final guidelines in respect of BEPS, it is expected that several jurisdictions will introduce amended transfer pricing legislation. The UK government has already released significant funds to the UK tax authorities to help them challenge abusive transfer pricing arrangements and strengthen its risk assessment capability across large business.

Carden: In the US, the IRS has significantly increased its enforcement efforts, as reflected in its decision to litigate several major transfer pricing cases in 2015 and 2016. Outside of the litigation context, the IRS has also increased its transfer pricing enforcement staff, which has resulted in more comprehensive and coordinated audit efforts. Finally, near the end of 2015, new proposed regulations were issued governing the CbCR obligations that will apply to US multinationals. While it is not clear how the IRS will use the information provided in the CbCR reports, it seems likely to lead to additional and more focused enforcement efforts.

Schwarte: Transfer pricing has been given a significant increase in attention in the global media in the past year due to some large transfer pricing disputes, state aid discussions and BEPS. Such media attention puts a certain pressure on tax authorities to increase their focus on transfer pricing. In the Netherlands, the Dutch tax authorities have significantly expanded the size of the so-called 'transfer pricing coordination group', which is in charge of coordinating transfer pricing audit policies.

Musselli: A lot of governments are dedicating more resources to audit firm policies and their revenue agencies are training dedicated staff to enforce methodologies of evaluation which are summarised in OECD guidelines and action plans, and in their national legislations.

Gaspar: While it is clear, internationally, that governments are becoming stricter in relation to transfer pricing, BEPS being one

good example, in Brazil this is not necessarily the case in my perception; at least not necessarily in terms of following global trends of changing regulation. Brazil revamped its transfer pricing regulations in 2012, bringing it closer to ALS in some aspects, but the general basis is still around fixed margins. Although I would hope for changes toward full ALS methods and a link to the OECD's guidelines, I do not see it happening in the near future.

Gracia: The Spanish tax administration is paying increasing attention to transfer pricing as evidenced by the fact that it is rapidly filling the ranks of the new International Taxation National Bureau for negotiating advance pricing agreements (APAs) and also for giving faster and more accurate guidance to tax auditors in the field when they come across transfer pricing issues in the course of ordinary tax audit exercises.

Curd: Much of the OECD's work is simply a reaction to the public's unfavourable understanding of contemporary international tax law. Multinational companies we work with have not only looked to minimise their exposure to potential BEPS guidelines, but also to minimise their potential exposure to negative publicity. While transfer pricing has always been a field with shifting regulatory guidelines, it is quickly becoming a shooting gallery for those unhappy with modern economic realities. We have seen an increased number of public hearings where the government lambastes tax directors of large multinational companies, fuelling criticism where it may not be justified. Countries around the world are creating new tax laws or amending existing laws to raise the bar on documentation requirements and penalties.

FW: In your experience, are companies now placing greater importance on the issue of transfer pricing? Is an increase in tax audits driving this change in emphasis?

Gaspar: Multinationals are definitely more concerned with transfer pricing in Brazil following the increase in tax audits. Not only do I see a growing trend in specialised consulting firms offering transfer pricing-related services to companies but also companies hiring in-house tax staff with some level of transfer pricing experience. Having an in-house transfer pricing specialist can be fruitful to the extent that transfer pricing regulation has to be taken into account when designing businesses and deals to prevent or mitigate a potential future tax assessment and litigation.

Schwarte: We have noticed an increased focus on transfer pricing from our clients. The BEPS projects came along with a great deal of media attention that has reached tax directors of practically all companies. Furthermore, more strict transfer pricing rules have or are on the verge of being implemented in many G20/OECD countries around the world, making it a necessity for companies to place greater importance on transfer pricing. In addition, the Dutch state aid case, Starbucks, which is fully about transfer pricing, results in a lot of discussion with and among clients.

Gracia: Companies are more aware of the importance of transfer pricing. Back in 2007 to 2009 there were a series of legislative changes in this area in Spain, but actually until tax audits started focusing on transfer pricing documentation obligations, then on more substantive transfer pricing issues, resulting in a high number of reassessments, taxpayers were not paying enough attention to this area. In recent years, there has been growing concern about what transfer pricing entails, and many more organisations are giving these issues the importance that they deserve. ▶▶

In the US, the IRS has significantly increased its enforcement efforts, as reflected in its decision to litigate several major transfer pricing cases in 2015 and 2016.

NATHANIEL CARDEN

Curd: Tax audits have been an inescapable reality for all multinationals, but their increasing frequency is alarming. In addition to increased audits, multinational companies have faced more comprehensive reviews of statutory financials by their financial statement auditors. Even smaller companies are seeing the benefits of having more complete defensive reports instead of minimal compliance. In addition to tax audits, the fact that anything to do with international tax has such a poor perception among the global populous is driving companies to place greater importance on their internal transfer pricing.

Greinert: Many companies are becoming more cautious when setting up a new transfer pricing system and are regularly reviewing their existing transfer pricing policy with respect to changes in international transfer pricing regulation. This is partly due to an increase in tax audits and a stronger focus of the tax authorities on transfer pricing issues. Companies are proactively placing more importance on the issue of transfer pricing to have more legal certainty in future tax audits and to avoid reputational risk arising from their transfer pricing policies and the strong focus of the media on this subject.

Muselli: Firms are placing greater importance on transfer pricing and in their fiscal departments. A lot of groups are training staff and commissioning independent advisers to explain the reasons behind their policies. The increase in audits has compelled firms to place greater importance on the matter.

Carden: Transfer pricing has been a primary area of focus in companies' tax planning and compliance for a number of years. However, the BEPS reports and related country-specific developments are placing an increasing focus on the relationship between corporate functions and income allocation. Historically, many companies focused their transfer pricing economic analysis on contractual allocations of risk and identification of third party comparables. Because the BEPS reports significantly broaden tax authorities' ability to recharacterise transactions based on a multinational's functions, the ability to rely on third party transactions is far less clear.

Secular: Many companies are waking up to the fact that transfer pricing is of much greater importance and have updated their systems to ensure that they are prepared for the changes. Unfortunately, several are still adopting a 'wait and see' approach in the belief that tax authorities are under-resourced and anticipate that there are bigger targets that will be investigated first. The introduction of CbCR will, however, give considerably more information to tax authorities around the world through the exchange of information clauses in double tax treaties, and it is likely that this will increase dramatically within the next few years the number of tax audits that will question transfer pricing transactions.

FW: Do you expect tax authorities to collaborate more frequently in cross-jurisdictional transfer pricing audits? In what ways does this approach affect participating countries and multinational companies?

Muselli: We must not forget that in the transfer pricing area, each government has different and contrasting interests – when one government increases its taxable income, another is losing taxable income. In my opinion, cooperation exists between governments of high taxation countries and is focused on auditing transfer pricing where the counterparty of an audited group is an

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ANDREA MUSSELLI

associated company located in a low taxation country. When both countries involved in intragroup transactions are high taxation countries, their tax authorities remain in a conflicting position, so real cooperation is less probable.

Greinert: Based on the final report of the OECD on Action 14 of the BEPS project, which aims to strengthen the effectiveness and efficiency of the mutual agreement procedure (MAP) process, and Germany's active role in the whole BEPS process, we expect that tax authorities will collaborate more frequently with other jurisdictions in transfer pricing audits. This should lead to a decrease in effective double taxation in transfer pricing audits, but will also have an impact on the duration of the MAP proceedings in the short run.

Secular: Tax authorities are already collaborating on cross-jurisdictional transfer pricing audits and the introduction of CbCR and the subsequent exchange of information between tax authorities will eventually lead to more cross-jurisdictional audits, although there is the obvious concern regarding confidentiality of taxpayer information which could be a challenge to launching joint audits in some of the less developed jurisdictions. However, under the CbCR requirements, multinationals will be giving much more information to tax authorities on their various transactions with connected parties, and this will definitely pave the way to increased collaboration on joint transfer pricing audits.

Curd: Fundamentally, every country is fighting for a single multinational to allocate more profit to their country. However, given the pressure on lower tax rate countries, such as Ireland, these countries want to be perceived as being global team players. In 2015, Ireland announced that it will be collecting CbC reports for fiscal years starting at or after 1 January 2016 from multinationals and distributing those CbC reports to other countries where the multinational company operates. It only makes sense for two countries to collaborate if they are mutually going after the profit in a third country, otherwise the fight for profit would move between the governments instead of with the taxpayer.

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 coord- ►

minated cross-jurisdictional audit has taken place. Perhaps the lack of possible credits arising from transfer pricing adjustments is the reason, or the fact that Brazil is still developing in this space.

Schwarte: Cooperation occurs, although not yet on a large scale. In the short term it will be interesting to see how tax authorities globally deal with all the information they will receive as a result of CbCR.

Gracia: The Spanish Tax Inspectorate has been participating in simultaneous tax audits – mainly focused on transfer pricing issues – for at least 10 years, always in the frame of the initiatives sponsored by the EU authorities and Member States. The Spanish tax authorities consider this kind of initiative instrumental to the wider and broader gathering of information which may then be used in the course of the tax audit run at the level of the taxpayer established in Spain. Multinationals will see many more of these simultaneous audits going forward, the risk being more frequent double taxation cases which will have to be addressed by way of MAPs and arbitration panels.

Carden: Historically, cooperation between tax authorities in different countries has worked well in disputes involving two relatively high tax countries, such as Canada-US, the EU countries, Japan-US, for example. In those instances, cooperation between tax authorities could inure to the benefit of tax administrations and taxpayers as well by reducing the period of time required to reach an agreement to apportion revenue income and avoid double taxation. Through simultaneous audits, countries could arrive independently at judgments concerning transfer pricing valuations before fixed positions had been arrived at concerning the amount of proposed adjustments.

FW: Are you seeing an increase in transfer pricing disputes between companies and tax authorities? What options are available to resolve such disputes at the earliest possible stage?

Gracia: We are certainly seeing an increase in transfer pricing controversies between companies and the Spanish tax authorities, since the most significant tax reassessments are often issued on transfer pricing matters. To the extent that transfer pricing reassessments do not carry a penalty, or the penalty is annulled by the

courts, the best available option for resolving transfer pricing disputes is the arbitration procedure set forth by the EU Arbitration Convention, or one of the few bilateral treaties signed by Spain which contemplate it – hopefully more, once the multilateral agreement implementing BEPS is approved and ratified.

Carden: It has been our experience that both the number of controversies involving transfer pricing issues and the amount of the adjustments involved in these controversies have grown progressively larger over the past few years. We expect this trend to continue in 2016 notwithstanding pending cases. In part, this development is a result of the focus in transfer pricing on the transfer and valuation of intangibles between related parties. Because intangibles are difficult to value and questions arise concerning the ownership and classification of the intangibles transferred among related parties, the amount of proposed adjustments can become so large that it complicates the ability to reach a settlement.

Secular: There has not been a significant increase in transfer pricing disputes in the UK recently, although there has been a shift in focus to more significant areas such as intellectual property and royalties. However, with the introduction of the DPT and the CbCR requirements, it is expected that there will be many more questions raised in 2017 onwards, as the 2015 corporate tax returns filed in 2016 are reviewed. The UK tax authorities have been under-resourced in recent years but the UK government has released significant funds for the tax authorities to employ and train more staff and this will definitely lead to more and specific focused enquiries.

Curd: We are seeing more transfer pricing audits in countries that historically did not have regulations or many audits. We have also seen more aggressive positions being taken by tax authorities that have had well established transfer pricing laws. While there has been an increase in audits, the processes by which to address the audit stay mainly the same. We have always supported trying to educate the tax auditors on the company facts and global inter-company relationships at the beginning of an audit in hopes that it will limit the length of the audit and resolve in the first level.

Gaspar: I have seen an increase in tax assessments related to transfer pricing. It almost necessarily means litigation, 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 generally can take more than a decade, up until a final decision at the judicial Supreme Court level is obtained.

Schwarte: We do not necessarily see a large increase in transfer pricing disputes between companies and tax authorities, but that may be attributable to the Dutch way of dealing with audits: few of them end up in court, especially transfer pricing cases, as usually a compromise is reached in the audit phase. What we do see is that tax authorities are being more critical about transfer pricing structures than before. Cases that gained significant media attention, such as the *Starbucks* and *Fiat* cases, have made tax and transfer pricing issues more familiar to the general public, and as such tax inspectors feel pressure to review cases more critically.

Musselli: When audits and challenges by governments increase, so does judicial litigation. A lot of legislation offers an ‘internal tool’ to avoid judicial litigation; this is when a discount on penal- ►

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FABIO GASPAR

ties is given to firms if they accept the tax authorities' upward income adjustment. In any case, another way to solve litigations is enforced by international tax treaties, where groups hope to avoid double taxation by asking for a downward income company adjustment when an upward income company adjustment is made in the jurisdiction of the counterparty of the transaction. This tool is strongly incentivised when the downward income adjustment is mandatory, as it is among European Union countries.

Greinert: Transfer pricing disputes with German tax authorities have been constantly increasing over the last couple of years. In order to resolve such disputes, multinationals can appeal to the national court or apply for a MAP based on the respective double tax treaty. Alternatively, if applicable, they can apply for an arbitration based on the EU arbitration proceedings which provide for a mandatory elimination of the double taxation. To avoid potential double taxation before carrying out the intercompany transaction, companies can also apply for an APA.

FW: In your opinion, how are recent, high-profile transfer pricing disputes impacting the way companies develop and implement their transfer pricing strategies?

Secular: I do not think that, currently, there have been enough high-profile transfer pricing disputes that have led to multinationals significantly changing their transfer pricing strategies, but I firmly believe that multinationals doing business in the UK are now considering the impact of the DPT introduced by the UK tax authorities in 2015, and the CbCR requirements that are beginning to be introduced on the global stage. Further consideration will follow as the OECD issues its final guidelines on BEPS and tax authorities globally enact legislation accordingly. Transfer pricing strategies will have to change within the next three years to reflect these changes and the increased documentation requirements that will exist.

Schwarte: The most famous transfer pricing dispute that affected the Netherlands in recent years was the dispute between the European Commission and the Netherlands, of which the latter was accused of giving illegal state aid to Starbucks. This case could have a significant impact on transfer pricing structures, as many companies have transfer pricing strategies in place that are similar to Starbucks' transfer pricing system. Both Starbucks and the Netherlands have appealed against the verdict of the European Commission so it will take much longer before we know for sure whether or not the verdict will impact companies.

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 track ongoing administrative litigation cases and, when it comes to judicial cases, there are currently very few of these underway. The lack of jurisprudence to guide taxpayers on how to interpret the legislation is an additional source of uncertainty, as either other taxpayers will not know about transfer pricing administrative court decisions or will they find out about them many years later.

Greinert: The recent transfer pricing disputes, as well as EU state aid procedures, have shown that transfer pricing strategies can become public and lead to a reputational risk for companies. The focus of transfer pricing planning has therefore moved away from a pure compliance and effective tax rate subject to a rather holistic topic, involving communication strategies and the overall corpo-

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DR MARKUS GREINERT

rate strategy of the multinational group.

Gracia: Transfer pricing disputes have been aired by the media and NGOs and put at the top of the agenda of political concerns by many governments and parliaments, hence creating an atmosphere which may be impacting the reputation of the firms involved. Hence, other companies are adopting a wary stance when dealing with their global transfer pricing policies. Post-BEPS, corporate structures must be more sustainable than before, particularly on the risk-taking side, which, among others, entails that relevant people must be seconded to the territories where the value-added is declared.

Musselli: Transfer pricing disputes do impact the policies adopted by firms. For instance, we can look at what happens to so-called web companies – Google, Amazon, Apple, and others – when high taxation countries realise a loss of revenue in favour of low taxation countries. In Italy, tax authorities accused Apple of booking profits generated in Italy through an Irish subsidiary in an effort to lower its taxable income base and save nearly €900m between 2008 and 2014. Apple agreed, at the end of 2015, to pay nearly €330m and to have recognised a hidden permanent establishment in Italy generating income in that country.

Carden: As of the beginning of 2016, there are several high profile transfer pricing cases pending in front of the US Tax Court or awaiting review in the US Court of Appeals. These pending cases involve both cost sharing and licensing of intangibles. Many companies are awaiting guidance from the courts prior to making major transfer pricing policy decisions, as each of these cases presents important issues regarding both the interpretation of regulations and the application of the arm's length standard more generally. Because the Tax Court's decision in Altera demonstrates that reviewing courts are not willing to blindly accept the IRS's view of transfer pricing cases, many companies are now waiting for court guidance rather than following historical IRS practice.

Curd: The adage that valuation is more of an art than a science is also applicable to transfer pricing. Tax authorities, at an increasing rate, are challenging companies' transfer pricing mechanisms in hope of increasing tax revenue. Interpreting transfer pricing ►

regulations is highly subjective and thus tax authorities are always going to be able to find areas to challenge taxpayers. I believe that companies are aware of this trend and are attempting to mitigate audit risk by spending more time and money in the early transfer pricing planning stages and the preparation of defensive documentation.

FW: In your opinion, have the changes made to tax regulatory frameworks helped or hindered multinationals in their understanding of potential transfer pricing liabilities?

Schwarte: The changes have been implemented in the first place to assure more transparency between different countries, enabling tax authorities to better assess transfer pricing systems. The transfer pricing burden on companies has, as a result, increased. However, I feel this does help companies to better understand potential transfer pricing liabilities, as companies are forced to draft detailed documentation and to describe their intercompany transactions in more detail. This could potentially reveal transfer pricing risks – risks of which a company was not previously aware.

Musselli: New tax regulatory frameworks have helped firms to understand that they may have transfer pricing liabilities. Frankly speaking, the new regulatory framework is not always clear in enforcing the transfer pricing rules, so firms are left uncertain as to which rule should be applied. This is the consequence of contrasting interest between high taxation countries playing in the arena and where base erosion for one country is base increase for another. One case of great uncertainty is the rule on income sourcing from marketing intangibles and marketing activities.

Gracia: Recent changes have opened Pandora’s Box, in a way. There is much more subjectivity than before BEPS on the evaluation of the value added by each group’s entity contributing to the value chain. BEPS is led and driven by agencies seeking to collect more revenue, and each tax authority will put the emphasis on different items of the same value chain. I think it’s worth remembering that BEPS is going to be applied by many tax officers who are not trained on these very sophisticated concepts, so even if multinationals have a clear idea of what BEPS means, the controversies will arise more often, resulting in tax litigation.

New regulations, for the most part, require companies to disclose their global transfer pricing positions, whereas previously the focus was on the single country under review.

REBEL A. CURD

Carden: Currently, the transfer pricing regulatory framework is in a state of substantial flux. In the US, temporary and proposed regulations purport to integrate conceptually separate transactions in order to ensure that all ‘value’ is subject to tax. Depending on how these principles are interpreted and applied, they may reflect a significant departure from traditional US transfer pricing principles, which focused on specific assets and transactions in an effort to ensure that related party transactions were priced in a manner consistent with third party behaviour. By focusing on ‘value’ rather than transactions and assets, the new regulations introduce significant uncertainty into multinationals’ assessments of their US transfer pricing positions.

Secular: The various announcements from OECD on BEPS, and those from the tax authorities globally indicating how things will change on the back of the OECD announcements, should help multinationals understand how, within a few years, they will become the subject of additional scrutiny, and thus how prepared they should be for that ultimate situation. It will not happen overnight as multinationals will probably have to change their systems to ensure that, for instance, they can meet the CbCR requirements and identify all of the information they will need to file. There may be some problem areas with the CbCR requirements for SMEs which may be exempt from transfer pricing requirements within the UK but not necessarily in other jurisdictions, and this area could hinder SMEs in fully understanding their transfer pricing obligations and liabilities.

Curd: Changes to regulatory frameworks have been mostly in the form of compliancy, not new theory. Transfer pricing remains the same in that taxpayers have to defend the allocation of profit based on the functions, assets and risks taken on by each entity in their organisation. New regulations, for the most part, require companies to disclose their global transfer pricing positions, whereas previously the focus was on the single country under review. There are, however, outlier countries that may not follow the OECD theories, such as having fixed returns for certain transactions. While the analysis of liability of potential transfer pricing exposures remains similar to the past, tax authorities are more active, making the probability of audit and cost of defence higher, not the probability of liability higher.

Greinert: The recent changes to OECD transfer pricing guidelines in the BEPS project will lead to an increase in legal uncertainty with respect to the calculation of potential transfer pricing liabilities. Besides the already existing risk that the transfer price for a specific transaction might not be considered arm’s length in a tax audit, there is now also the risk that the complete transfer pricing system of a multinational will no longer be accepted by the tax authorities.

Gaspar: In Brazil, I have seen small changes in transfer pricing regulation recently. Notably, I have seen the enhancement of PCI and Pecex methods for commodities – somewhat similar to OECD’s CUP – with additional adjustments brought by rulings IN RFB 1.458/2014 and 1.568/2015, bringing them even closer to the ALS. Given these few changes are positive, to the extent that a multinational can make fair and marketable adjustments to transfer pricing, they will help companies do business better.

FW: If a company finds itself subject to a tax audit or investigation, how should it respond? What documentation should it gather in this event?



Secular: The first thing any company that finds itself subject to a tax audit or enquiry letter should do is consider taking professional advice. Unless the company has in-house people with experience of dealing with tax authorities on transfer pricing, expert advice is essential and no response to an enquiry or audit should ever be made unless professional advice has been sought. The initial response to an enquiry will set the scene for the future and it is important that that the key areas have been identified and the responses carefully thought through. Management must also be aware that they will have to devote significant time to dealing with the issue and that, often, the matter will not disappear after the initial response.

Greinert: The company should provide detailed transfer pricing documentation which includes a description of the group company and its ownership structure as well as information on the business activities of the group and the audited company. Furthermore, a detailed functional and risk analysis should be prepared, which provides information on the value chain within the group. Finally, the arm's length character of the transfer prices has to be shown. In case of regular business transactions, the transfer pricing documentation has to be provided to the tax auditor within 60 days upon request in Germany. For extraordinary business transactions, the documentation must be submitted within 30 days.

Gaspar: When it comes to audit or investigation, the best position for the taxpayer is to have prepared in advance. Having a strong internal process analysing transactions in advance, doing thorough work fitting the method chosen – given taxpayers can generally choose the method in Brazil – to adequate legal framework and grounds, and keeping documentation organised in advance, are key for a smooth process. It is worth emphasising the need for a thorough internal process within the organisation, with clear responsibility and accountability between areas to ensure a proper audit trail along the way on costs, documents and so on.

Schwarte: Companies should have transfer pricing documentation available, substantiating the arm's-length nature of their intercompany transactions. If such documentation is not available, under old rules many taxpayers were given a certain time – a month or six weeks – to prepare the required information. However, new rules in the Netherlands, for example, require a master and local file to be available at the time of filling the annual corporate income tax. Therefore, it is expected that such a long time to prepare the required documentation will no longer be given to taxpayers as of the end of 2016.

Gracia: The first thing a company should do is to get a good tax adviser to set the strategy of defence from the outset and make available to the tax administration the required transfer pricing documentation. In Spain, it is compulsory to keep available to the Spanish tax authorities the master file, the local file, and, from 1 January 2016, the CbCR for groups with a consolidated net turnover of at least €750m in 2015.

Curd: Despite the global increase in scrutiny, a large number of companies are still unprepared for a dispute. While annual documentation is a compliance issue in many countries, it can be very expensive and time consuming to prepare, so taxpayers are sometimes constrained to the point that they prepare only a minimal amount of support for their transfer pricing. When there is a lack of proactive preparation of documentation, transactions can be overlooked and not addressed, which increases the likelihood of an audit investigation surprising the taxpayer with assessments and penalties. When transfer pricing is

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thoroughly reviewed proactively, there is less uncertainty.

Musselli: All firms are now ready to justify the economic reasons for intragroup prices and to show that they are at arm's length. For the biggest firms, the process is more intense and they are able to produce more appropriate documentation as to the best way to reach the arm's length result and achieve eventual independent comparables.

Carden: Transfer pricing audits, especially those involving intangibles, can quickly become 'fishing expeditions' that can consume large amounts of time and resources for the companies involved. Often the burden falls not only on the tax department, but also on other parts of the organisation that are asked to provide financial information, business documents, and sometimes even interviews. Consequently, we advise companies to be very proactive. Firstly, companies should assemble the financial information, documents and other organisational resources that will be needed, preferably in connection with any major intercompany transactions. Secondly, it is important to identify any documents that may be withheld under privilege or work product doctrine. Finally, and most importantly, companies must engage with the tax authorities to define the scope of the audit.

FW: What challenges do multinationals face when trying to maximise tax efficiency while remaining compliant with transfer pricing regulations?

Schwarte: The main challenge is that different countries have different transfer pricing regulations in place. One of the main goals of the BEPS project is to remove these differences, so as to create one global system. However, even under the BEPS project, countries still have freedom as to which BEPS rules they will implement or not. This will differ per country and therefore different legislation will remain in place between different G20/OECD countries. Furthermore, the difference in transfer pricing regulations between these 'BEPS' countries and other countries will remain.

Secular: The CbCR requirements are an example of the increasing burdens that multinationals face. As more and more transfer pricing regulations impose documentation requirements on multinationals, the opportunities to maximise tax efficiency may reduce. This is not to say that they will be eliminated, but there will be an increasing ►

need to bolster the commerciality rationale for establishing operations in a certain way that will, ultimately, increase the cost of such operations. The CbCR requirements will also increase the compliance costs and may lead to unexpected challenges as tax authorities share information with their counterparts in other jurisdictions.

Curd: The greatest challenges are the variances across different tax jurisdictions. For example, in Brazil, the law requires the transfer price be set at a specific margin that is not supportable by OECD standards, so the transaction is not supportable on the counter side of the transaction. Some taxpayers are subject to double taxation in order to comply with the rules of various countries. Additionally, the lack of resources or budget to keep up with the significant documentation efforts and information and data management is a challenge for multinational companies. Often tax departments are seen only as cost centres that do not contribute to the value of the company, so they are limited in both personnel and budget.

Gracia: Nowadays, the main challenge that multinationals face is to be able to demonstrate to the various national tax authorities that the added value has been generated in the territory where it is declared – in other words, that the added value has been correctly attributed to the various entities involved in this value chain, taking into account that each tax administration will try to justify a different attribution of the income for the benefit of its own tax collections.

Musselli: Aggressive tax planning is the focus of the OECD, and of several national governments, so maximising tax efficiency is now something very different from what we saw only seven years ago. Multinationals are now more oriented toward tax complaining than aggressive tax planning, and are very careful not to erode the tax base of industrialised countries when involved in a transaction with a low taxation country.

Gaspar: The first challenge multinationals find in Brazil when doing transfer pricing is the gap between local transfer pricing regulation and other countries' rules, notably the OECD's guidelines. While the former is based mostly on fixed margins, the latter is based upon ALS and reconciling both can be rather difficult. Lacking certainty in applying local methods can also mean added difficulty as a result of the limited paradigms arising from rulings issued by the Revenue Service and from courts, meaning a lack of specific

rules on intangibles which can cause a multiplicity of possible interpretations without any guidance from rulings or case law.

Carden: In my view, the most important consideration when developing a transfer pricing model that balances efficiency with compliance is ensuring that the model is consistent with a company's global functional platform and overall corporate strategy. This is especially true in the post-BEPS environment. On the functional side, many large multinationals, especially in the US, have traditionally managed their transfer pricing structures by relying principally on an economic investment model using funding by foreign affiliates. These investments remain critically important. However, both US and European transfer pricing enforcement look increasingly at people, not just dollars.

Greinert: One of the main challenges is that it becomes more and more difficult to comply with transfer pricing regulations on a global level in the first place, since the new OECD transfer pricing guidelines leave more room for interpretation and transfer pricing adjustments than before. In addition, some countries have implemented their own transfer pricing regulations which do not comply with the OECD approach. It will thus become more difficult for companies to determine the boundaries of the transfer pricing regulations within which they can implement a tax efficient and compliant transfer pricing system.

FW: As transfer pricing regulations continue to evolve, what do you expect to see in this area over the coming years? Is there a need for companies to continually review and update their internal tax processes?

Carden: Hopefully the next several years will bring additional clarity both in the application of US transfer pricing rules, as well as BEPS and EU state aid findings. As individual countries wrestle with the implementation of the 2015 BEPS reports, multinationals will have to adapt their policies and processes to adapt to these developments.

Secular: The OECD will issue final guidelines on BEPS and governments will amend or introduce transfer pricing legislation to enact those guidelines. Additional legislation is also a possibility as tax authorities share information that they have gathered under the CbCR requirements, attempt to understand the way in which businesses operate globally, and seek to either tax multinationals that operate in their jurisdiction but may not have an actual presence, or increase the tax take from multinationals that do have a presence there. It is essential that companies continually review their tax position with external advisers and update regularly their internal tax processes as more and more legislation is passed.

Greinert: We expect to see an increase in the quality of transfer pricing audits in Germany due to the often highly-skilled tax auditors and new national and international transfer pricing regulations. Multinationals will therefore need to regularly review and update their global transfer pricing strategies. The CbCR standard for the transfer pricing documentation, initiated by the OECD and which is expected to be implemented in Germany as of 2016, will further increase the need for companies to have an internal process in place that allows them to regularly monitor the transfer pricing outcomes of the group companies and respond to any changes.

Curd: Since the OECD has already published many fundamental aspects of transfer pricing, leaving open only a limited number of ►►

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topics, 2016 is a good time for a comprehensive, open minded review of the transfer pricing policies of a multinational group. This would ideally require the combination of two different types of knowledge: a deep knowledge and understanding of the new OECD perspective and a deep knowledge of the business and its strategic trends. Many companies are already BEPS compliant in theory, but may need an update as to how they document and defend their structure.

Musselli: The OECD BEPS project already includes future developments and more and more we will be seeing the new transparency level requested from multinationals. For instance, under CbCR firms will have to show which activities are managed and how taxation levels are reached in different countries. Also, fiscal administrations will have to publicly show which rulings they agree with, under the automatic exchange of tax rulings between European countries.

Schwarte: The coming years will most likely be about implementing BEPS and agreeing on automated exchange of information between the G20/OECD countries. These changes can and will have an effect on companies. Before BEPS is implemented and before automated exchange of information has been agreed between countries, companies might be required to, for example, submit a CbC report in more than one country. Therefore, companies should closely monitor developments in all countries where they have a presence. Having a BEPS proof transfer pricing system in place minimises the changes for companies having to update or adjust transfer pricing documentation once a country has implemented BEPS in its national law, as most countries are expected to follow BEPS regulations.

Gracia: I expect to see continuous monitoring in the area of transfer pricing over the coming years, as an increasingly important issue for multinational companies. In particular, it is important to bear in mind the reputational risks that can arise from the application of a specific transfer pricing policy. In addition, I believe that the tax function within multinational companies should be raised to and monitored by the company's board of directors, especially in terms of the transfer pricing strategy that each multinational group decides to apply.

Gaspar: Despite the outcomes of the BEPS project published in 2015, and the fact that Brazil was involved as a G20 member, my opinion is that the tax authorities in Brazil feel comfortable with the current fixed margin methods and should not give up the 'simplicity' and 'control' they provide. Although I would hope for changes toward full ALS methods, and a link to OECD's guidelines, I do not see it happening in the near future. Nevertheless, we do believe that authorities will keep using and improving current regulations to seek more scrutiny and that tax audits will remain an important item in the Revenue Service agenda.

FW: What final piece of advice can you offer to companies in the process of amending their existing transfer pricing policies?

Curd: While significant tax dollars can be saved through efficient tax planning, complex transfer pricing structures can cost more money to implement and maintain than more simplistic ones. Companies should be just as concerned with the cost of any compliance work needed to prove intercompany payments are being made at arm's length. Documentation should thoroughly explain the global structure and be updated based on new guidelines to ensure BEPS compliance. With the addition of CbCR, companies are being asked

by tax authorities to increasingly provide more transparency relating to their global operations.

Gracia: I would suggest that, going forward, investors and multinational groups, and in particular US ones, assume that they will have to pay more taxes and in more of the jurisdictions where they are operating abroad. This assumption would then help them to set tax strategies focused on optimising tax costs, but more in line with BEPS. This would be less risky and controversial, and hence less costly to defend and sustain.

Gaspar: As far as Brazil is concerned, I would expect authorities to continue focusing on transfer pricing audits throughout 2016 and with increased sophistication in doing so. Due to the fact that local regulation is subject to different interpretation, all transactions need to be carefully documented and the legal grounds which they rely on need to be well detailed in advance. Moreover, I would really insist on the importance of doing all the transfer pricing work in advance, and to have a clear internal process on the way to go about this between all the involved areas in the company.

Carden: Unfortunately, the transfer pricing landscape changes in 2015 raise more uncertainty than they resolve. Moreover, 2016 may bring additional developments, both in US courts and – however unlikely in an election year – international tax reform. However, one pattern seems clearly poised to continue in the near term: the emphasis of tax authorities on functions and 'substance'. As a result, tax departments should work closely with their counterparts in operating lines of business to enhance the alignment of their transfer pricing policies with underlying business operations.

Schwarte: The most important advice is to be prepared for what's coming. Be aware of the consequences of the BEPS project and determine a global transfer pricing strategy. Many countries are expected to update their transfer pricing regulations this year or in 2017, and by closely monitoring this process in all the countries where a company is present, no unexpected compliance issues should arise. Furthermore, companies should perform a global check to determine whether or not, even in countries that have not implemented BEPS, they comply with BEPS regulations.

Musselli: Firms must take care to study intragroup transactions as regards the best way to show why they are priced at arm's length. Strong economic support for a transfer pricing policy is obviously the best way to achieve compliance with fiscal rules. Then, appropriate documentation processes must be installed.

Greinert: Companies should proactively review their existing transfer pricing policies with regard to the changes of the new documentation requirements of the OECD. It should be checked whether all information that has to be provided to the tax authorities as part of the CbC report is available and whether the global transfer pricing system and the information given in the report is consistent.

Secular: Any company that is either in the process of amending its existing transfer pricing policies or contemplating doing so, should ideally seek professional advice and assistance if it has not already done so. The changes that have already been introduced in the UK and other jurisdictions, and the changes that will be introduced over the next two to three years, have and will have widespread implications, and if multinationals are not fully prepared in advance they may find themselves under detailed scrutiny and facing increasing levels of penalties and interest. ■