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A Post-BEPS Primer for CFOs: Is the In-House Transfer Pricing Team in Control?

The authors set forth a practical approach for chief financial officers seeking to ensure the company's transfer pricing team is fulfilling its risk-management, communication and general compliance obligations.

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The role of a company's chief financial officer is under more scrutiny today than ever before, both internally and externally. As transfer pricing has become increasingly associated with tax avoidance in the mainstream media, it has become paramount for CFOs to ensure that their transfer pricing teams execute strategies in a way that transfer pricing and cross-border structuring do not undermine a company's reputation.

CFOs' expectations of a transfer pricing team typically center on the following three elements:

- adequate and timely management of transfer pricing compliance cycles,
- proper risk management, and
- structural internal and external stakeholder communication on various transfer pricing positions.

Most companies have struggled for years to effectively and continuously implement and monitor transfer pricing policies throughout the organization. Often, this is because transfer pricing teams are too focused on gaining technical transfer pricing expertise and spend too little time on developing a process. Given the added administrative burdens, including country-by-country reporting, that have resulted from the OECD's two-year project to combat base erosion and profit shifting (BEPS),[1] transfer pricing teams now will have even less time to devote to risk management and communication.

The BEPS project has put transfer pricing at center stage and will require more operational substance to support positions taken. CFOs need to make sure that transfer pricing policies are properly executed in the business and owned and managed by the relevant business levels as well.

This article sets forth some guidelines on how CFOs can ensure that their transfer pricing teams are aware

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[1] The Organization for Economic Cooperation and Development's final guidance under the BEPS project (see http://www.oecd.org/tax/beps-2015-final-reports.htm) includes a report on documentation and country-by-country reporting, covered under Action 13 of the 15-point BEPS action plan. See Kevin A. Bell and Rick Mitchell, ''Country-by-Country Plan May Be Project's Greatest Legacy,'' 24 Transfer Pricing Report 756, 10/15/15.

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and in control of the multinational's global transfer pricing risks.

Practical Tips

Careful transfer pricing planning facilitated by good organizational and operational management practices is critical to avoid inaccurate or inconsistent implementation of transfer pricing policies, which, of course, can lead to an array of issues such as year-end transfer pricing adjustments, double taxation, transfer pricing penalties and audits—and damage to a company's reputation.

For example, lack of processes and controls over transfer pricing can lead to late filing, or failure to file, transfer pricing documentation. Deciding what are the key focus areas and clearly allocating roles and responsibilities between the in-house transfer pricing teams and external advisers by defining who should be responsible, accountable, consulted or informed on various transfer pricing work flows is a starting point for organizing the structure of transfer pricing governance and control framework.

Also, in many instances, the use of manual, spreadsheet-based processes for calculating transfer pricing means not only that an unreasonable number of hours are spent on validating and manipulating data into a usable format, but also that transfer pricing decisions are based on incorrect data. Software customized to a multinational's specific needs can dramatically increase the efficiency of the transfer pricing compliance cycle.

Another common example is poor internal communication. The head of transfer pricing is supposed to communicate policy to all subsidiaries, and subsidiaries, in turn, are responsible for implementing transfer pricing policy and reporting back about the status of compliance. If communication lines between the head of transfer pricing and subsidiaries as well as the head of transfer pricing and the CFO are not clearly defined, the CFO does not have a full overview of the company's transfer pricing risks and cannot ensure that the company's "in control" statement is maintained.

To avoid unnecessary risks, CFOs must get an accurate and transparent view of what occupies their transfer pricing teams day to day. The authors recommend a two-step approach:

1. Push toward a more streamlined transfer pricing process by encouraging an open dialogue between transfer pricing teams on various structural and operational transfer pricing issues.

2. Ensure proper and timely transfer pricing communication among various internal and external stakeholders by putting in place a well-structured communication plan.

These steps are explained in more detail further below.

Validating the 'In Control' Statement

The lists of questions below illustrate the structural as well as operational (annual) aspects CFOs and their transfer pricing teams should discuss to assess how well-equipped and up-to-date the teams are regarding the three key elements necessary for staying in control of transfer pricing risks mentioned above—managing transfer pricing compliance cycles, managing risk and communicating with internal and external stakeholders about transfer pricing positions.

Top 10 Structural Questions

Structural questions focus on organizational transfer pricing aspects (for example, transfer pricing output production calendars, succession planning and information technology systems) and encourage in-house transfer pricing teams to take a mid- to long-term view on transfer pricing planning.

1. How do you execute successor planning of your transfer pricing team?

2. Do you have successor planning in place for your role and responsibility?

3. Do you have a production calendar defined for each relevant transfer pricing work flow (corporate income tax, wages, value-added or goods-and-services tax, transfer pricing)?

4. What is your transfer pricing dashboard—software that tracks all relevant work flows and communication lines—for staying in control?

5. How do you report your transfer pricing dashboard, and to whom?

6. What level of automation has been achieved in the last 12 months or will be achieved in the next 12 months?

7. How do you allocate time among three areas—designing, documenting and defending your transfer pricing system?

8. How is knowledge management—technical and "soft" transfer pricing skills—organized in your company?

9. Do you work closely with the commercial departments? Do business and transfer pricing teams have an open communication line and do they regularly update each other on relevant business model changes or activities?

10. Do you have a clear understanding of your organization's business strategy and business model or models?

Top 10 Annual Questions

Annual questions focus on the in-house transfer pricing team's day-to-day responsibilities and help the CFO gain an understanding of how effectively the in-house transfer pricing team deals with short-term transfer pricing planning.

1. When will you complete last year's transfer pricing documentation cycle—production, calendars for transfer pricing, master file, local files, central country-by-country reporting and local transfer pricing forms?

2. How do you manage your transfer pricing risks?

3. Which savings or overruns in the consulting budget and the internal budget are anticipated or realized this year?

4. Can you accurately specify—that is, line by line or year by year—the tax provision in the U.S. books associated with transfer pricing risks? pr

5. Do you have a capacity planning for your team for the next 12 months and do you see any mismatches?

6. Is there any significant backlog in transfer pricing work flows (including development and maintenance of documentation, audit support, consulting, risk management, systems, capacity planning, global benchmarking platform, sign-off processes and legal agreements)? Are these work flows included into your dashboard?

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7. Do you expect large audits with major adjustments by tax authorities this year?

8. To what level are support and input required from finance and commercial departments in the next 12 months?

9. How much of your time in the next 12 months will be spend on each of these three areas—the transfer pricing compliance cycle, transfer pricing risk management and communication on transfer pricing issues to internal or external parties?

10. What are the top three major opportunities and threats for your company's transfer pricing position in the next 12 months?

The appendix to this article, a graphic depiction of an in-house transfer pricing team's ''in control'' statement, shows where the in-house team falls short of reaching the level of compliance met by its peer group.

Communication

Proper and timely communication between the CFO and the head of transfer pricing plays another important role in managing transfer pricing risks. CFOs should always be updated on any deviations between transfer pricing policy and actual compliance. The best approach to communication between the CFO and the transfer pricing team might be the following:

- **Required once-a-year communication** between the CFO and head of transfer pricing to keep track of structural transfer pricing questions.
- **Required quarterly communication** between the CFO and head of transfer pricing to keep track of annual transfer pricing questions.
- **A monthly face-to-face meeting** between the CFO and head of transfer pricing to discuss any deviations from planned outcomes, especially those related to compliance.
- **Communication on a case-by-case basis** between the CFO and head of transfer pricing to create a risk-mitigation plan for identified outliers.

A communication plan that clearly identifies the key organizational and operational aspects of the transfer pricing function and sets clear guidance about format and timing will ensure that the transfer pricing team spends its time and effort on the most important requirements and delivers what it needs to deliver in a timely manner.

Conclusion

If the head of transfer pricing is not aware of the actual transfer pricing compliance risks that should be communicated back to CFO, the organization operates beyond a proper governance and control framework.

By using structured questionnaires and putting in place a well-defined and regular communication structure, CFOs can:

- get a much more accurate grip on transfer pricing reality;
- encourage a more process-oriented approach to transfer pricing among transfer pricing teams; and
- ensure that transfer pricing risks are managed efficiently and on time.

In other words, the ultimate ambition of being in control over a company's transfer pricing risks is achieved through:

- abetter functioning governance and control framework;
- enhanced certainty about existing and future transfer pricing positions and processes;
- proactive and actionable transfer pricing risk management; and
- facts-based communication to both internal and external stakeholders.

Appendix