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Observations from the Fiscalis¹ seminar in Hungary on November 20-21, 2007, “Transfer Pricing: How to conduct a transfer pricing audit”, suggest more resources be allocated to Member States’ officials understanding, increasing their potential to lead in transfer pricing within and outside the European Union.

The European Union’s initiative to take an active role in the development of transfer pricing with the commissioning of the “EU Joint Transfer Pricing Forum” (EUJTPF) in 2002 is now in its sixth year. Altogether 19 meetings are recorded of authorities from initially 15 and now 27 EU Member States and with observer status, of representatives from the OECD and the EU Commission. These joint public and private sector deliberations were aided initially by 10 and now 15 professionals with insights from industries and business consultancies.

Due to the recent enlargement of the European Union (in 2004 and 2007) from 15 to 27 Member States this important project² will require the application of proven project management skills to gain progress and to find agreement within such a large group of professionals (and their respective governments) and to succeed with its ambitious agenda.

With Fiscalis the European Union established, almost concurrent to the EUJTPF, a multi-annual Community action programme, initially for the period from January 1, 2003 to December 31, 2007, to reinforce the functioning of the indirect taxation systems of the EU internal market.

“The objectives of this programme are:

to achieve among officials a high common standard of understanding of Community law, particularly in the indirect tax sphere, and of its implementation in the Member States;

to secure efficient, effective and extensive cooperation among the Member States and between them and the Commission;

to ensure the continuing improvement of administrative procedures so as to take account of the needs of administrations and taxpayers through the development and dissemination of administrative best practice.”³

To ensure these objectives to become reality professional training programmes – similar to the OECD outreach programmes – for delegated officials of all Member States including language skills were organised. An indeed formidable but necessary task should the overall goal of the EU common market’s competitiveness eventually be achieved.

Transfer pricing was on the agenda of the Fiscalis programme from the beginning and has gained in emphasis over the last years.⁴ This year’s seminar was addressed at the EU Member States’ tax inspectors. Within the group of more than 50 delegates they were to develop a better understanding of how and under what circumstances to conduct a transfer pricing audit. They were to consider the needs for prioritising their own resource utilisation and to recognise the significant resources devoted by multinational enterprises for safeguarding against any undue transfer pricing risk exposure. Transfer pricing practitioners from Baker & McKenzie⁵ and the author were invited to share private sector experiences with the officials. They presented how multinational corporations develop their documentation assisted by specialised transfer pricing consultancies and the corporations’ best practice of preparing for transfer pricing audits. A welcome support for these efforts is noted in the commitments from the OECD⁶ and competent authorities from the U.K. and Belgium.⁷

Edward Morris,⁸ chairing the Fiscalis seminar, stressed in his opening remarks the complexity of transfer pricing and particularly the unprecedented burden on governments and corporations alike. The ever increasing cost of compliance and the aim of corporations to mitigate the risk exposure resulting from transfer pricing unduly eats into the profits which both governments and corporations are aiming at to have their share of.

Conference language

As it is common practice in proceedings organised by the European Commission, the Fiscalis seminar also provided for simultaneous interpretation facilities to and from English, French, German and, in this case, Hungarian. With relief it was noted that this actually was necessary only for a few delegates. On this working level the European integration has advanced already to the extent that most of the officials were comfortable with English while following the presentations as well as during the discussions thereafter.

Training approach

Prior to the seminar delegates received electronically submitted presentations and case studies for their individual perusal.

Presentations from the Hungarian, the Belgian and the U.K. competent authorities as well as from the OECD and the private sector representatives offered advice from the most experienced in transfer pricing – from the perspective of the authorities as well as that of multinational enterprises.

Presentations and ensuing discourse

A hopeful sign of *Zeitgeist* became evident in the presentations by Sam Shephard and the author, with both focussing on the issues surrounding risk assessments. The perspectives from the U.K. competent authority and from the business representative congenially matched as both explored and emphasised the benefits of such a business-like approach.

Under a new approach to transfer pricing, being introduced in 2008, U.K. auditors will be required to submit a business case to dedicated transfer pricing specialists before officially taking up a new transfer pricing case and starting an audit. This will include an estimate of the tax at risk and the resource requirements for carrying out an enquiry. A new enquiry will be commenced only with the approval of transfer pricing specialists, who will be involved in the conduct of every transfer pricing enquiry.

HMRC has shown itself to be sensitive to the costs, both to itself and to taxpayers, involved in large and time-consuming transfer pricing audits already since 2002 with Tax Bulletin 60.⁹ Now, with its June 20, 2007 publication¹⁰ “promoting a collaborative debate with our customers” and by using a risk review template, HMRC has presented a commendable business-like approach, the practice of which will be followed attentively.

A caveat has already been raised from the business perspective because of GlaxoSmithKline and HMRC still reporting an imminent litigation on the grounds of double taxation. After 17(!) years of inconclusive negotiations and the eventual settlement with the IRS in late 2006 both the corporate group as well as the U.S. and the U.K. governments have incurred management time and expenditures hitherto unheard of. This must be the loss-loss against the ideal of a win-win situation in transfer pricing and should become the no-no example to deter anyone from repeating such an inordinate consumption of public and private funds.¹¹

Interestingly, there was much reference and query as to the number of parties involved in a transfer pricing audit. The tax inspectors were considering as many as in bilateral competent authority negotiations.

The private sector representative on the other hand made a strong point to enhance the awareness of the authorities as to the immense resources of management time blocked and monies spent over an uncertain time period.¹² Communications and, when it comes to expenditures, negotiations are necessary between corporate functions not only with the management of the group company under (potential) audit but also with the affected related group companies' management and that of their respective regional and corporate levels.

In addition to internal resources – the corporate functions transfer pricing, accounting, controlling, legal, tax, finance, the board of management and the supervisory board including their legal compliance function and audit committee (as well as their counterparts on the regional and national levels) – resources from external auditing firms and specialised transfer pricing consultants are either part of the project team or to be reported to from time to time. Depending on the complexity of the organisational structure of the multinational enterprise

another management layer may need to become involved as well.

Similarly, in nation states with a decentralised structure of governments multinational corporations have seen transfer pricing audits unduly prolonged as a result of an opaque system of supremacy and decision making between their respective local, regional and federal authorities.

All of the reasoning above clearly mandates the corporate transfer pricing function in multinational enterprises to prepare and therewith to safeguard the organisation with the implementation of a Transfer Pricing Risk Management Programme throughout the group of companies.¹³

Case Studies

Seven simplified case studies were intended to uniquely represent the auditors' scenario with six of them providing the supposedly common situation of rather limited information available to auditors. They were meant to inspire the analytical mind of the tax inspectors to make a decision for or against opening an enquiry and starting an audit.

At the other extreme, the attending fiscal authorities were confronted with a full blown documentation package containing a sample transfer pricing policy and benchmark analysis of a multinational enterprise prepared by Baker & McKenzie.¹⁴ The auditors were asked to consider the transfer pricing study and raise their concerns, if any. Intangibles for marketing efforts and the related level of royalty payments were the focus of analysis. The auditors proposed adjustments prior to realistically postured negotiations with the (mock) taxpayer and its counsel Monique van Herksen and Pierre-Yves Bourtourault. The case study subsequently required the respective tax authorities to engage in competent authority discussions to defend their proposed adjustments and to obtain relief from double taxation for the taxpayer. This proved to be as challenging as the negotiations with the taxpayer in agreeing to an adjustment.

The approach to create a rather realistic and therewith educative exercise resulted in a spontaneous discourse between the auditors who hitherto neither knew the case nor each other, but may be facing each other in real-life negotiations soon. Their exercise clearly demonstrated to everyone the broader (than domestic) mindset needed for adequately solving transfer pricing cases: a global view with the ability to accept the need for considerable flexibility could prove to be the key for productive decision making.

Time frame

Harvard University is known to be the originator of case studies in training business students as well as corporate executives under time pressure – however, not as severe as it was the case at this seminar. It was apparent to everyone that the absorption of complex content, dialogue (for most in a foreign language) about facts and circumstances relevant for decision making requires time, more than there was available. Already from the outset it became clear, therefore, that deliberations had to be limited to only a few cases and therein a few pivotal issues.

The approach setting up mock negotiations between auditors and tax payers was much appreciated, which would have

been the case even more so would there have been more opportunity to do so.

Where to go from here?

Budget considerations were given as reason for limiting also this year's Fiscalis seminar to only two days. Given the complexity of the issues on the agenda, the need for Member States' officials to become fully in command of the international dimensions of the transfer pricing work, and the skill-building benefit that case studies provide, a full week – as it is the practice in the much valued outreach programmes directed to non-OECD Member States – would be appropriate and prove to be a good investment.

The efforts demonstrated by the public and private contributors and the attending tax officials could prove to generate significant productivity if also the Fiscalis programme could gain support from a new leadership drive in transfer pricing.¹⁵ More resources specifically devoted to such Public Private Partnerships are needed if this leadership potential is to be realised.

The payback for Member States' tax administrations and multinational enterprises alike will come quickly when the full understanding has sunk in of Europe being foremost in competition with the rest of the world, rather than among its Member States. Here, as elsewhere, transfer pricing should not evolve into another competitive disadvantage. Rather, the same principles should be applied the world over under the guiding umbrella of the OECD.

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1 For details on FISCALIS see <http://europa.eu/scadplus/leg/en/lvb/l31037.htm>

2 The proceedings of the 19 EUJTPF-meetings, key documents and curricula vitae of the newly elected 15 business members can be reviewed at http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/forum/index_en.htm.

Commentary is provided by the media specialising on transfer pricing, see for instance: Van Stappen, Dirk. "EU Commission issues APA guidelines based on the work of the EU Joint Transfer

Pricing Forum". *Tax Planning International Transfer Pricing*, Vol.7, No.7, July 2007; Van Stappen, Dirk. "EU. JTPF making progress". *Tax Planning International Transfer Pricing*, Vol.4, No.9, September 2003; Van Stappen, Dirk. "European Union: first meeting of the Joint Transfer Pricing Forum". *Tax Planning International European Union Focus*, Vol.4, No.10, October 2002; Van Stappen, Dirk. "EU Joint Transfer Pricing Forum established", *Tax Planning International Transfer Pricing*, Vol.3, No.9, September 2002.

3 See: <http://europa.eu/scadplus/leg/en/lvb/l31037.htm>

4 Four seminars on Transfer Pricing issues have been organised within the framework of the Fiscalis Programme: "Transfer Pricing and EU Arbitration Convention" (November 2003), "Organisation Structures and Training Methodologies for Transfer Pricing Audits" (2004), "The use of database searches for comparables" (2005) and "Transfer Pricing and intangibles" (2006).

5 Monique van Herksen (Netherlands) and Pierre-Yves Bourtourault (France)

6 Colin Clavey, Senior Advisor, Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD

7 Sam Shephard (HMRC) and Stefaan De Baets (Belgian Tax Administration)

8 European Commission, DG-TAXUD, Responsible for EU Joint Transfer Pricing Forum and EU Arbitration Convention; former U.K. competent authority

9 See: www.hmrc.gov.uk/bulletins/tb60.htm, "Risk Assessment Process"

10 "HMRC Approach to Transfer Pricing for Large Business, Consultation Document", See: www.hmrc.gov.uk/large-business/new-approach.htm

11 The author is, of course, aware and on record that all of the intelligence having gone into preparing for the defence of GlaxoSmithKline in the U.S. courts would in all probability have brought a positive decision for the pharmaceutical-biotech industry on the issue of "marketing intangibles". However, not having been resolved in the U.S., it has now by chain reaction evolved into a claim of precedence by many other fiscal authorities not only against U.S. corporations.

12 Consider also FIN 48 reporting requirements: Wright, Tamu, "10-Q FIN 48 Disclosures Show Firms Uncertain About How Transfer Pricing Positions Will Be Viewed", BNA's *Tax Management Transfer Pricing Report*, Vol.16, No.10, September 25, 2007.

13 Wündisch, Karl "Optimale Organisation des Transfer Pricing als Risk Management Programm", in *Internationale Verrechnungspreise*, Lektion 5, Management Circle Verlag, 2. Auflage, Eschborn 2007

14 *BNA Tax Portfolio*, Practical Applications in a Transfer Pricing Study – A Case Study by Marc M. Levy, Phil Carmichael, James Dougherty, Monique van Herksen, all with Baker & McKenzie, New York or Amsterdam.

15 As it has been suggested in the author's earlier article referenced in the biographical paragraph.