Best Practices in Transfer Pricing Compliance

Nearly 20 years have passed since the Internal Revenue Service (IRS) instituted requirements that taxpayers document their intercompany transactions, and over a decade has passed since the IRS issued the "Langdon Memo" alerting U.S. taxpayers that such documentation would need to be produced upon audit. Meanwhile, the vast majority of foreign countries have implemented their own transfer pricing regulations, and transfer pricing compliance has become the primary focus of fiscal authorities across the globe.

It is safe to assume that virtually all multinational corporations (MNCs) have been producing some form of transfer pricing documentation on a regular basis for many years now, and that their transfer pricing has been subjected to numerous audits in multiple jurisdictions.

The questions these organizations face today are not whether to produce documentation but rather how best to manage their transfer pricing compliance process to minimize the various risks associated with their intercompany transactions. For complex organizations with a significant global presence, navigating the myriad country-specific compliance requirements can be extremely resource-intensive and even overwhelming.

Our experience in assisting hundreds of MNCs with transfer pricing matters has been that many approach transfer pricing compliance requirements in a less-than-optimal fashion. Most MNCs would benefit from applying basic risk management principles prior to determining what to do and when to do it.

Companies should consider starting with a simple list of the primary risks that they are trying to manage in the transfer pricing compliance process. Typically foremost among these risks are penalties. Special attention and consideration should also be given to significant transactions between entities in countries with large tax rate differentials or that lack reliable mutual agreement procedures that may expose a company to economic losses or even double taxation.

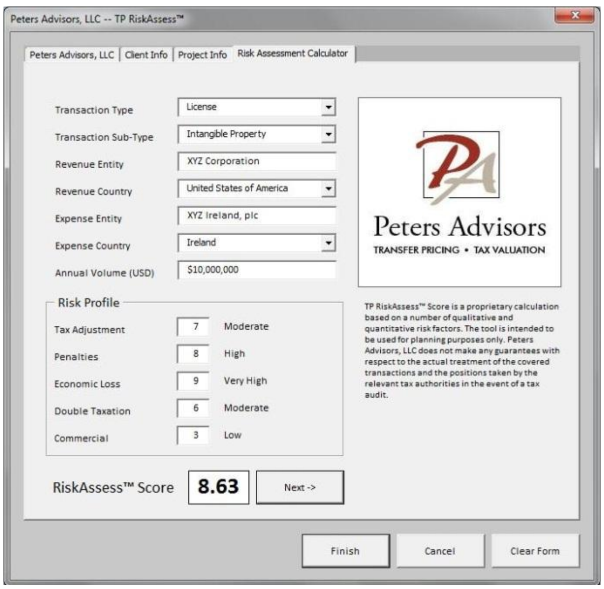
The nature of the intercompany transaction should also be considered. Is the transaction, and the methodology used to test it, relatively routine in nature? Or is the transaction typically controversial – such as a royalty for the license of an intangible asset – or is it tested in a manner that is not conventional?

Once an MNC has established its risk profile by transaction and by country, the allocation of its resources to minimize risk follows naturally. For example, a company may consider only documenting the transfer pricing of its cost-plus service centers every two or even three years, on the assumption that the pricing is non-controversial and the transacting parties are in countries with similar tax rates and good tax treaties. It may also be possible to establish materiality thresholds for intercompany transactions of a certain type on the premise that even the most significant potential tax adjustment would not likely trigger U.S. Section 6662 penalties.

All of these matters require important and difficult value judgments for tax departments that generally do not have the budget or personnel required to actively manage 100 percent of their transfer pricing compliance risks.

At Peters Advisors, we believe that the key to developing a sound approach to global transfer pricing compliance is to "measure twice and cut once." Simply by identifying and prioritizing the key transfer pricing issues faced by your company, you can redirect your firm's resources to where they provide the most benefit, resulting in enhanced global compliance coverage at a fraction of the cost.

In order to assist our clients in this regard, we have developed TP RiskAssess™, an internal proprietary tool that ranks an MNC's intercompany transactions according to their risk level. TP RiskAssess™ takes into consideration a number of key risk drivers, including the volume and nature of the transactions, jurisdictions and audit histories of the entities involved, as well as company-specific risk adjustment factors tailored to the profile and objectives of the company.



If you are interested in learning more about how you can improve your company's global compliance strategy, contact us to discuss your transfer pricing risk profile.

Visit us at www.petersadvisors.com.

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