



2016 Transfer Pricing Survey Series

In the spotlight

A new era of transparency and risk



This report is the first in a series discussing EY's global 2016 Transfer Pricing Survey. It highlights the most significant findings and sets the stage for a deeper exploration of key topics in subsequent editions. These forthcoming reports will also suggest detailed actions for companies to consider. To receive other reports in the series, please visit ey.com/tpseries or connect with your local EY Tax contact.

Contents

3

In the spotlight: a new era of transparency and risk for transfer pricing

16

How businesses should respond

18

Conclusion

Welcome to EY's 2016 Transfer Pricing Survey Series, where we collect and analyze input from taxpayers on what they are seeing in practice in a variety of aspects across the transfer pricing life cycle.

This first report in the series presents the overall highlights of the survey. The second report will focus on how survey respondents are reacting to the implementation of anti-base erosion and profit shifting (BEPS) recommendations by the Organisation for Economic Co-operation and Development (OECD). The third report will examine strategies for managing transfer pricing risk. And the fourth and final report will explore the operational implications. For each report, we will provide a concrete set of recommendations that readers can take away to make their jobs easier.

In 2013, our previous survey identified two important trends emerging in the market that are indicated in the new survey results as facts of the transfer pricing life cycle.

First, we concluded that the transfer pricing life cycle – the interval from designing and implementing a transfer pricing model until it becomes subject to audit – itself was shortening, with controversy arising significantly earlier in the cycle. New survey results, in fact, find that this phenomenon is now commonplace because tax authorities possess a greater range of enforcement tools, along with increasing resources.

We also concluded that risks were increasingly lurking in emerging markets, but businesses continued to concentrate their resources in mature economies where transfer pricing risk was more predictable. Our research and analysis suggest that even though more risk is afoot, not enough businesses have shifted their resources to the appropriate jurisdictions.

These trends are becoming more widespread because governments around the world will soon have unfettered access to corporation information, giving them more

insights than ever. These governments are already demonstrating their willingness to use such wider means to obtain data to build cases for higher tax revenues; this will only increase once country-by-country reporting (CbCR) comes in. As a result, businesses need to begin taking steps to deal with the new normal in transparency and taxation.

This begins with preparing contemporaneous documentation in support of current transfer pricing policies and strategies. This is needed to be in place as it is no longer a case of if controversy is coming, it is when – and businesses must be prepared to defend their practices in the light of day. And they must also be prepared to do so in locations they may not have previously considered risky.

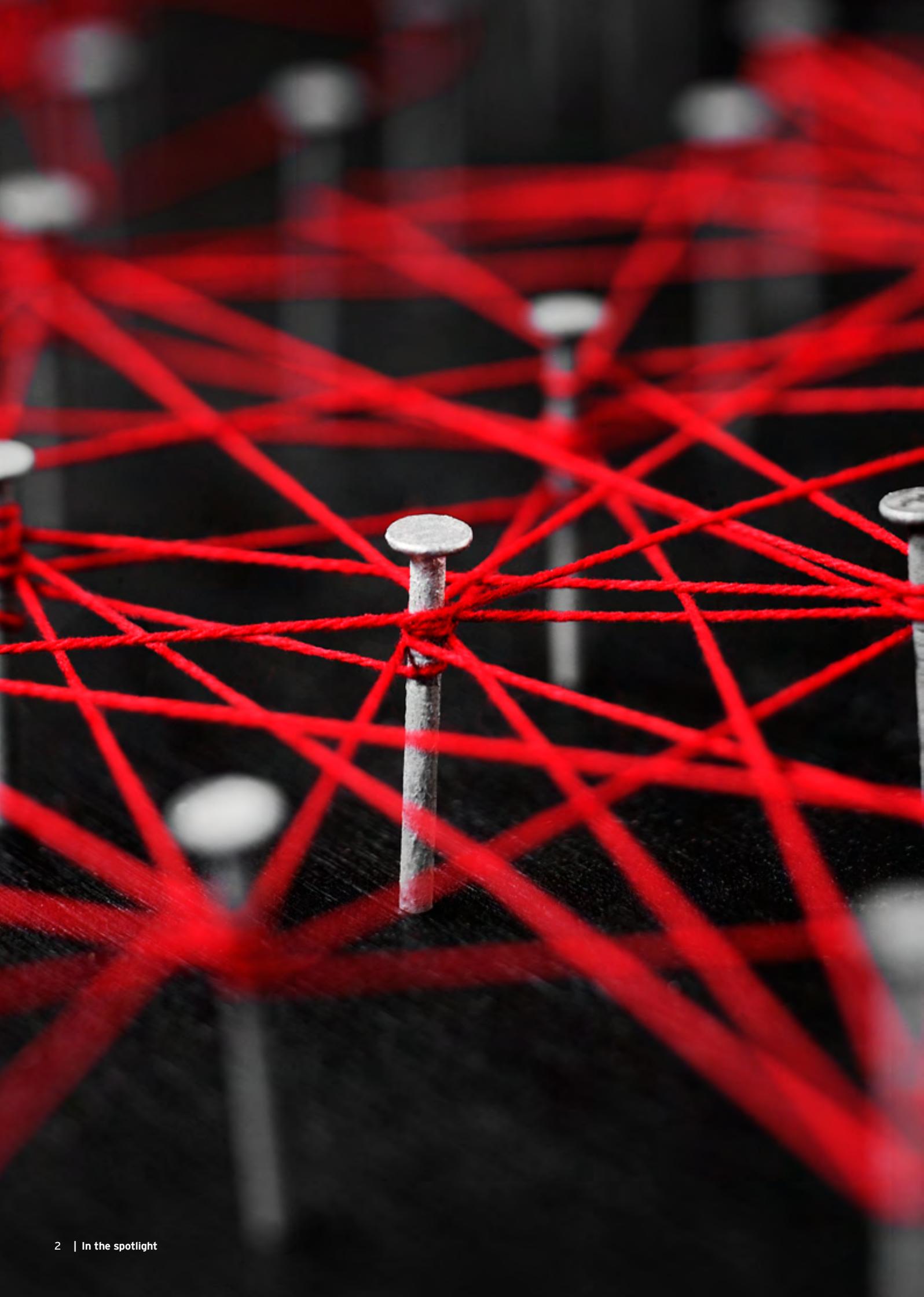
Over the longer term, businesses need to begin gathering essential data and insights to build a clearer and more optimized long-term strategy for transfer pricing, particularly in terms of ownership and management of intangible property (IP), and align their global resources accordingly. Companies will also need to carefully examine their operating model to facilitate compliance with the new BEPS rules recommended by the OECD, such as in the area of permanent establishment (PE). As for IP, anti-BEPS rules and other local initiatives mean that companies need to do more to demonstrate the true substance behind any pricing arrangements.

More transparency is driving change throughout modern tax functions. Companies themselves will be compelled to share more, providing a clear window into transfer pricing strategies and practices. Adapting to this new reality will be key to executing effective and compliant transfer pricing. We hope this series catalyzes you to action.

Finally, a personal note; this is the 10th rendition of this Transfer Pricing survey, first produced in 1995. It is also the last one I will oversee. After 21 years, I am retiring from EY. The very capable Peter Griffin will step into the role as EY Global Transfer Pricing Leader. We produce this report for you. I hope you've found it to be useful. I wish you the very best.



John Hobster
Outgoing EY Global Transfer Pricing Leader



In the spotlight: a new era of transparency and risk for transfer pricing

2016 EY Transfer Pricing Survey Series

Transfer pricing is like string art, where colored thread pulled taut connects pins to form geometric shapes. Each connection is critical to crafting the final image. Over time, these patterns can grow more and more elaborate and complicated, but in the end, they should form a working system. The network depends ultimately on the integrity of the string remaining taut. Snip anywhere, and the entire picture can unravel.

Of course, art, like transfer pricing, can be a matter of interpretation. Where one person sees beauty, another feels indifference or, worse, takes offense. Our 2016 survey indicates that transfer pricing has entered an era of heightened tax risk and controversy, driven by an exponential increase in the demand for tax-related transparency. In response to heightened calls from activists and collection agencies, tax rules are being designed and implemented in a more comprehensive manner the world over. This is forcing companies to share significantly more details regarding their operating data and tax strategies, both publicly and in materials available to tax authorities. This further aligns with BEPS outputs and messages from the United Nations, both of which intensify the spotlight on the local activities of multinational groups.

At the same time, the more companies have to disclose, the more they will find themselves examined, and possibly misunderstood, by both tax activist pressures and tax collectors using deeper insight to demand more income. The questions become:

- ▶ What changes are taking place in the tax risk landscape, and where are the instances of controversy becoming more prominent?

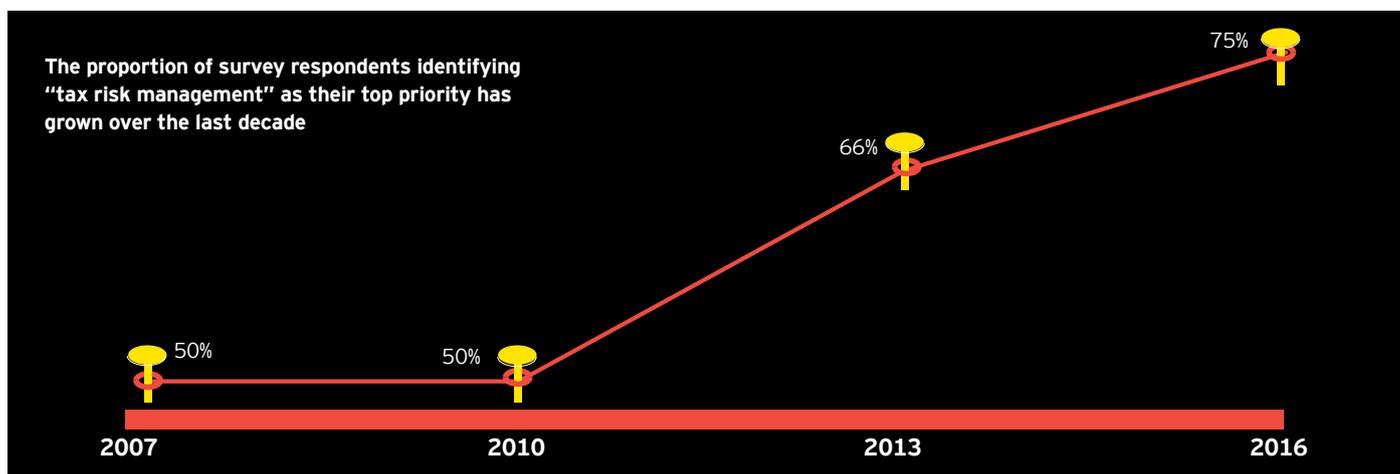
- ▶ What rules are being written to alter the mix in transparency and compliance, and how are they being interpreted?
- ▶ What proactive operational steps are needed for companies to stay ahead of today's transfer pricing realities?

An era of heightened risks

EY's 2016 survey of 623 transfer pricing executives in 36 jurisdictions across 17 industries finds that respondents are encountering significantly more transfer pricing disputes in more jurisdictions than in the past. And, perhaps more significantly for the months and years to come, respondents are anticipating an expanding swath of conflict spanning a wider range of geographies across a broader range of issues.

The field of play since our last survey has shifted so dramatically that the number of firms indicating "tax risk management" as their top transfer pricing priority has surged to 75%, up from 66% in our 2013 survey; in 2007 and 2010, that proportion was just 50%. The increased risk aversion found in this year's survey was prevalent across all industries, although it reached 88% for the banking and capital markets and wealth and asset management sectors.

EY Global Transfer Pricing Leader Peter Griffin explains that across all industries, "managing tax risk – which means avoiding audits if possible but prevailing when they happen, avoiding double taxation and above all, protecting the reputation of the company – is becoming far and away the highest priority within transfer pricing."



Though industry findings are relatively consistent, there are some geography-based variances. For example, only 65% of respondents from the Americas indicate that tax risk management is their top transfer pricing priority. These respondents are, meanwhile, over twice as likely to focus on optimizing their effective tax rate (ETR) as others in the survey – 14% vs. 6% overall. On the other end of the spectrum, some 81% of Japanese-based businesses identified risk management as their top priority. Europe (75%), Australia and New Zealand (75%), and the rest of the Asia-Pacific region (72%) were broadly in line with the global results.

The fact that transfer pricing has become one of the most visible and controversial topics in the global tax avoidance debate has contributed to the new risk aversion. In recent years, transfer pricing has attracted the attention of the news media, politicians and social justice groups that suspect multinational corporations use transfer pricing to pay less than a “fair share” of tax.

Largely as a product of this heightened visibility, tax authorities are under pressure to implement greater and unprecedented demands for transparency about multinationals’ operations, tax profiles and effective tax rates, and show tangible outcomes from this.

As of October 2016, 44 countries have implemented all or some of the BEPS recommendations, creating the potential for some conflicting interpretations. In all, more than 80 countries globally are committed to implementation. This compels more disclosure about a business’s transfer pricing activities in the aggregate, and how this aligns to the operating model. But it also necessitates a shift from a reactive stance to a proactive review of policies, procedures and operations so that any inevitable disclosures contain nothing untoward. Companies today must increasingly demonstrate that they are following not only the letter but also the spirit of the tax and transfer pricing rules – as should any responsible corporate citizen.

While companies are facing greater risk of controversy, upward adjustments and fines, “their reputations and all that accompanies any brand risk are also increasingly at stake,” says Griffin. “The twin pressures of transparency and public skepticism about how companies conduct transfer pricing have thus propelled risk management to the forefront of concerns for not only the transfer pricing professionals but also the C-suite executives to whom they report.”

Controversy: are priorities aligned?

The OECD’s recommendations for curtailing BEPS will be an enormous source of added transparency and risk to taxpayers. CbCR, for example, injects vastly more operational and tax data into profit and loss discussions with revenue collectors. A second requirement to maintain both a master and local file for related party transactions enhances prior documentation requirements. In both cases, it is more critical than ever that businesses relay current and accurate data that matches their business activities and operating model, and aligns with the tax story presented to authorities and the public.

As Griffin explains, “taxing authorities have essentially outsourced the collection of a vast amount of data to multinational corporations. Now these agencies will scour the data, combing it for opportunities to make cases for greater revenues.” Consequently, says Griffin, “businesses must be proactive, critically and thoroughly examining their own data, operations and transfer pricing to strategies for consistency and compliance.”

Perhaps driven by the concern that these requirements may increase the likelihood of activists and legislators gaining access to more information to fuel their arguments, a growing number of entities are voluntarily and openly presenting more tax-related information.¹ These firms are actually moving ahead of and often beyond the impending public disclosure requirements in certain jurisdictions. Their idea is that a more comprehensive disclosure can be used to strengthen their marketplace image as a solid corporate citizen and taxpayer as well as bolster their position on transfer pricing in advance of controversy proceedings.

¹ Bill Millar. “A Change of Plan.” *Tax Insights for business leaders*. No. 17. October 2016. Pp. 18-22.

Dealing with controversy: trends in APAs and competent authorities

In a post-BEPS world, it will be more important than ever for companies to test advance pricing agreements (APAs), bilateral APAs (BAPAs) and other prefilling arrangements against their global footprints. Tax authorities around the world are likely to access APA information and will test whatever the APA says against the company's activities in their own country.

Two out of three respondents (65%) say that, going forward, they expect to increase their use of APAs during and post-BEPS implementation. As Dave Canale, EY Global Leader for Transfer Pricing Controversy Services, explains, "in some cases for clients, certainty is essential, and in such instances, where available, we're more apt to pursue an APA, bilateral or multilateral, or at the very least, seek some form of agreement of understanding with the host authorities."

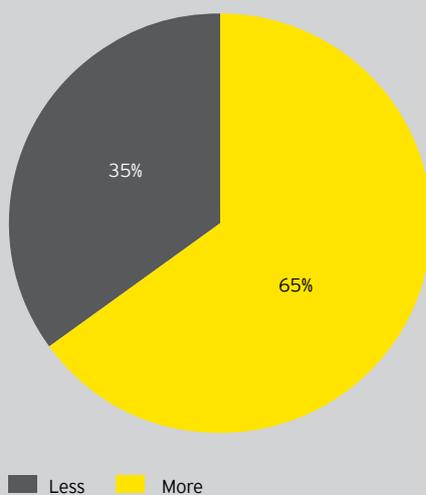
But in terms of current numbers, those who make use of APAs to mitigate controversy are still in the minority. Only 37% of firms say they are using either bilateral APAs (16%), unilateral APAs (14%) or a combination of the two (7%). Note that efforts

to include VAT, customs valuation or other indirect taxes within APA negotiations is a rare exception (evidenced in fewer than 5% of cases).

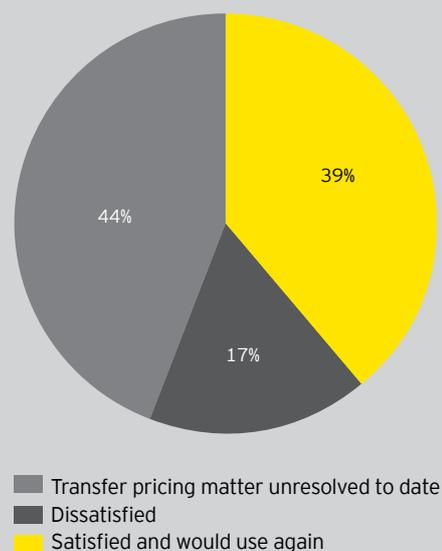
Among current users of APAs, a strong majority are satisfied with the process and its results, including 75% of those in the UK, 70% in the US and 73% from the "rest of the world." Note that the satisfaction figure dips to 58% among those negotiating APAs with Canada. The key reasons cited for dissatisfaction with APAs is that the process takes too long (69%) or leads to undesired or bad outcomes (15%) or onerous compliance requirements (6%).

An alternate method for dealing with tax controversy is to submit the issue to the competent authority and let governments negotiate between themselves. One-quarter of respondents in the 2016 survey report have taken this step. Though 44% of respondents report that the matter is not yet resolved, among the completed cases, 39% say they are satisfied and would use the process again – with only 17% dissatisfied.

Respondents anticipate using more APAs in post-BEPS environment



Satisfaction levels with competent authority process





One thing that is certain is that the new landscape “will require companies to ensure that they can demonstrate a close alignment of legal ownership with the management of intangibles, especially where intangibles-based income arises in lower tax jurisdictions.”

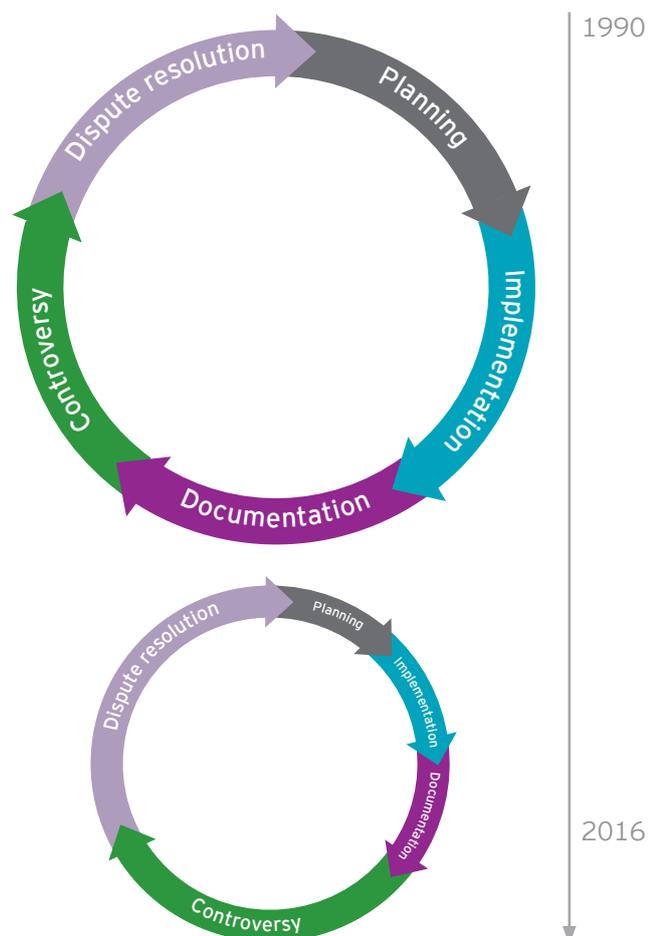
– Cornelius Grossmann
EY Law Leader

A quicker cycle with more flash points

As mentioned earlier, we identified that the transfer pricing life cycle itself was shortening, with controversy being pushed earlier in the cycle, and that in emerging markets, businesses are not increasingly building their resources.

Tax authorities around the world will soon have unfettered access to more information than ever before, and they are already using wider sources of data and sharing information to build cases for higher tax revenues.

A shorter, faster transfer pricing life cycle



Businesses will need to confirm that they possess contemporaneous documentation in support of current transfer pricing policies and strategies, and compare their alignment to disclosures such as the CbCR and other public filings and releases. Businesses must be proactively prepared to defend their practices, and do that in the locations they may not have previously considered risky.

Businesses also need to begin gathering essential data and insights to build a clearer and more optimized long-term strategy for transfer pricing. This includes paying attention to the new rules under BEPS for permanent establishment (PE) – a broader definition means more business models will become subject to taxation. As a result, businesses need to adjust how we go to market in a number of situations. Holistically, executives must determine and be ready to provide that data which is most likely to be requested by authorities.

The BEPS recommendations also include tighter restrictions on how companies can levy charges for IP, brands and related intangibles than those previously used in many IP models. As a result, companies need to do more to demonstrate true substance behind the development, enhancement, management, protection and enhancement (DEMPE) functions focused on in

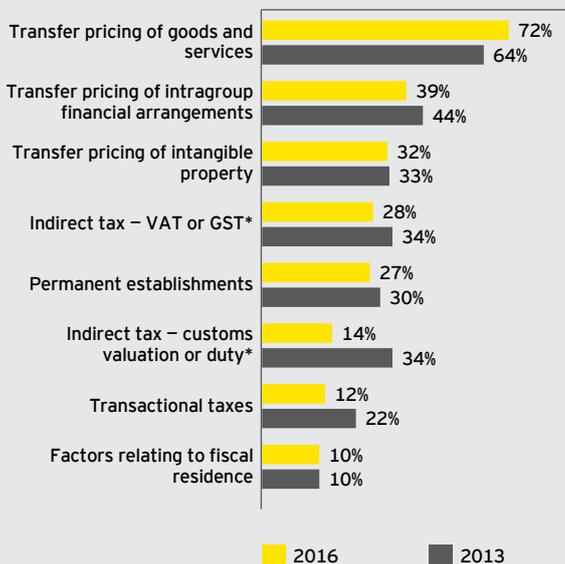
relation to such intangibles to justify the level of charging across borders. Absent sufficient substance, companies will need to make appropriate, meaningful changes to either their operations (staffing, expertise, facilities) in support of IP or to their intangibles-based transfer pricing – or be prepared to reduce such pricing. One thing that is certain is that the new landscape “will require companies to ensure that they can demonstrate a close alignment of legal ownership with the management of intangibles, especially where intangibles-based income arises in lower tax jurisdictions,” says Cornelius Grossmann, EY Law Leader.

Greater enforcement, not surprisingly, is the most frequently cited (39%) tax risk factor driving transfer pricing strategies today. Moreover, four out of five respondents (79%) believe that post-BEPS implementation, tax controversies will actually become more difficult to dispute, which in turn takes longer to fight.

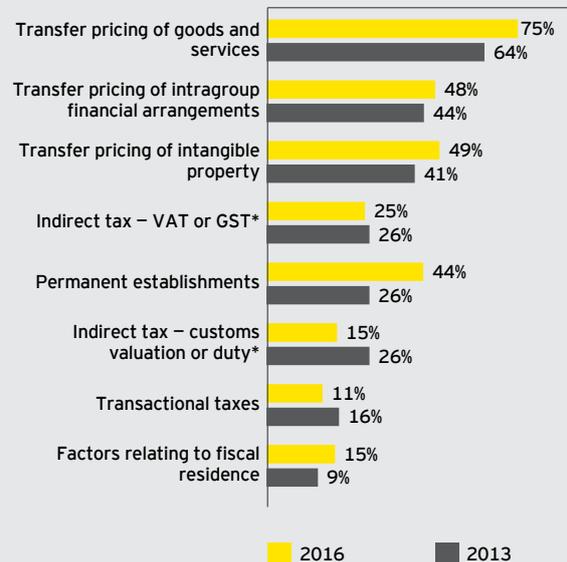
In terms of risk, the key source of controversy – both over the past three years and fueling expectations for the next two years – is the explicit transfer pricing of goods and services. Specifically, 72% of respondents indicate that their transfer prices in these areas have been a core focus of past controversy whereas 75% expect this to be the case going forward. Note that this is consistent with the 2013 survey, although the figures for both the past three and the next two years are slightly elevated.

Leading sources of tax controversy in transfer pricing

Which have been your most important areas of tax controversy in the last three years?



In the next two years, which of the same areas do you expect to be the most important areas of controversy with regard to tax?



* Indirect tax was one single choice in 2012 survey. Multiple responses allowed.

Controversy relating to intragroup financing arrangements has fallen slightly over the past three years as compared to the 2013 survey, being a major concern for 39% of respondents. However, the figure, going forward, will increase significantly to include nearly half of firms (48%) anticipating potential controversy in this area.

“This will create challenges because multinationals have been developing their in-house treasury capabilities, which has escalated the volume of intercompany loans, guarantees and cash pooling,” says Danielle Donovan, Asia-Pacific Financial Services Transfer Pricing Leader. “There is also now the increased focus to contend with the level of return associated with financing activities as part of key development activities.”

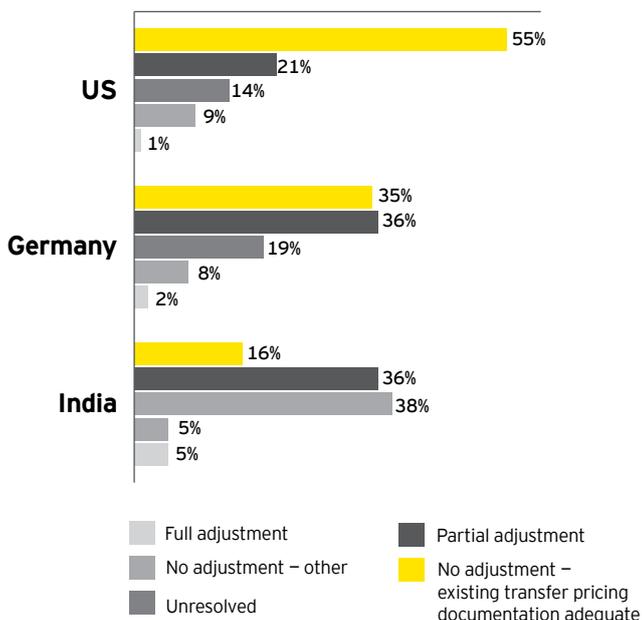
By far, the largest anticipated increases in controversy center on transfer pricing for IP and PEs, both key focuses of the BEPS project (see page 11). Just under one-third of companies (32%) say that they have experienced such issues related to IP over the past three years. But looking out over the next two years, the figure climbs to nearly half (49%). PE-related controversy has been an issue over the past three years for about one in four respondents (27%). But over the next two years, undoubtedly driven by both the BEPS project as well as local law changes, the figure is anticipated to climb significantly to 44%.

Revisiting resource allocation: which jurisdictions are active?

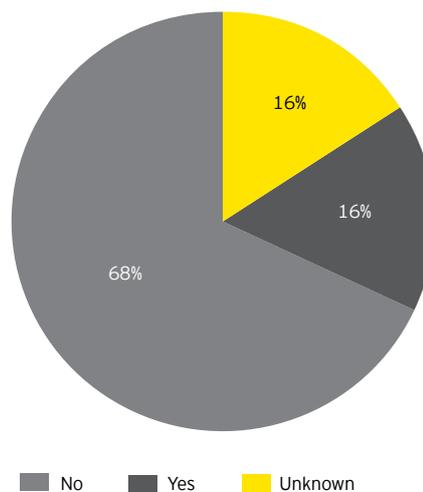
Levels of worldwide tax authority activities are definitely on the increase. Still, there may be a mismatch between where activity levels are the highest and where new resources are being allocated.

The new survey shows that the respondents are increasingly prioritizing developed economies when it comes to focus, staffing and resources. More than half of all respondents identified Western Europe (36%) and North America (26%) as their highest priority areas in the new survey, down from a combined 67% in 2013. The proportion of respondents identifying Brazil, Russia, India and China (BRIC) and African markets as their highest priorities also fell to just 6% from 12% just three years ago. So where is the shift? Toward Asia-Pacific, as there, the proportion of respondents identifying this region (excluding China) as their top priority rose to 28% (up from 12% just three years ago).

What is the outcome of the examination?



Were penalties imposed?



Top five respondent countries where penalties were imposed:

- ▶ Germany
- ▶ UK
- ▶ Switzerland
- ▶ Japan
- ▶ US

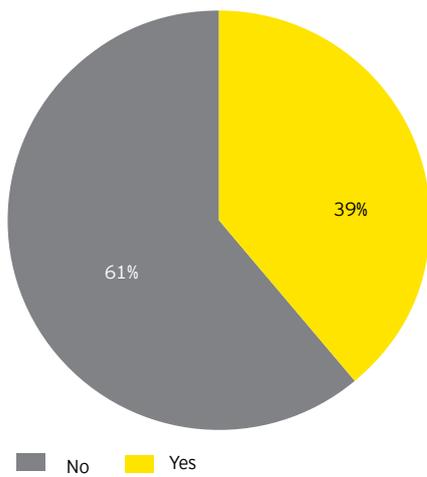
To a large degree, the survey continues to show a paradox between the markets that attract resources and the ones that actually cause trouble. Interestingly, in the 2013 survey, Germany (29%), the US (25%) and India (25%) were the three most frequently cited nations where transfer pricing policies have faced official examinations. Yet respondents reported no adjustments in 64% of US-based inquiries and 43% for Germany. By contrast, just 21% of Indian examinations resulted in no adjustment. Moreover, 38% of respondents say that their Indian cases remain unresolved, indicating that the procedures continue to be lengthy propositions. By comparison, just 19% and 14% of respondents say that their German and US cases were unresolved, respectively.

While it is true that companies will tend to see more controversy in developed nations because that is where the bulk of their cash flows circulate, on a value-weighted basis, emerging markets are actually far more risky from a tax perspective. And barely more than one-quarter of respondents (26%) say the way they allocate their transfer pricing resources corresponds to the importance of each region.

The value of risks within emerging markets might be lower, because the size of the operations is lower. But relative to the developed world, the frequency and severity of controversy in emerging markets are significantly greater. With transfer pricing controversy on the rise in places such as Russia, Africa and Latin America, and as tax authorities introduce new rules and increase their resources, companies should examine their resource allocation and devote greater focus on the world's likely trouble spots – the emerging markets.

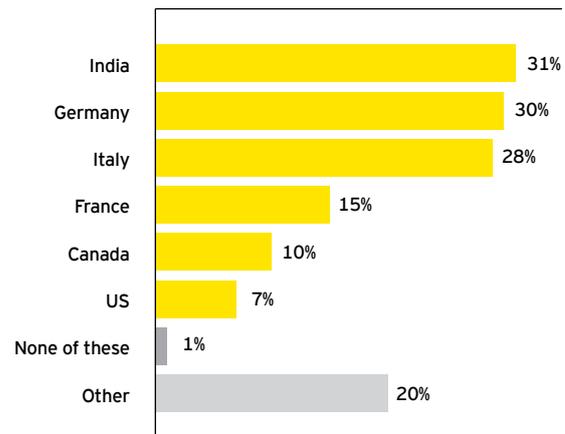
Whether or not companies need to shift resources in this regard, however, remains an open question. As EY EMEA Transfer Pricing Leader Oliver Wehnert explains, "The volume or value of transactions may be lower – which may be why these nations aren't ranked higher by the survey in terms of risk." Nonetheless, going forward, "companies can expect to see a great deal of more controversy in the developing markets, which from past experiences have been more demanding and unpredictable in approach."

Was interest imposed?



Numbers may not sum due to rounding

In which country or countries was interest imposed?



Multiple responses allowed

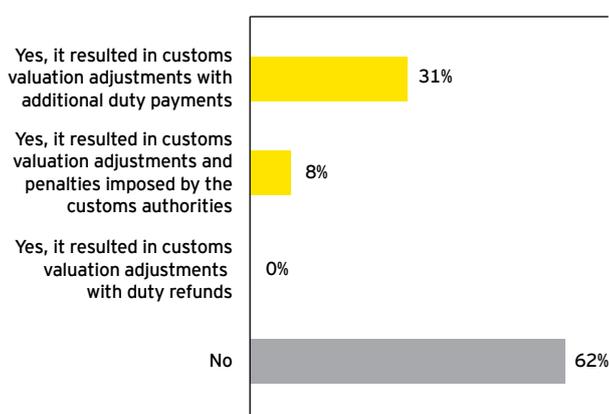


“While countries are moving at different speeds to implement BEPS recommendations, most are moving quickly to enact CbCR and additional transparency requirements.”

– Alex Postma
EY International Tax Leader

As an aside, we were anticipating seeing a greater level of customs involvement in transfer pricing audits when we put the survey in the field. This, however, hasn't yet translated into action, with customs authorities becoming involved in such examinations in only 10% of cases resulting in customs valuation adjustments and/or penalties in 39% of instances, which, while being surprisingly low, is consistent with the results of inclusion within APA negotiations.

Did transfer pricing adjustments result in customs valuation changes and/or penalties?



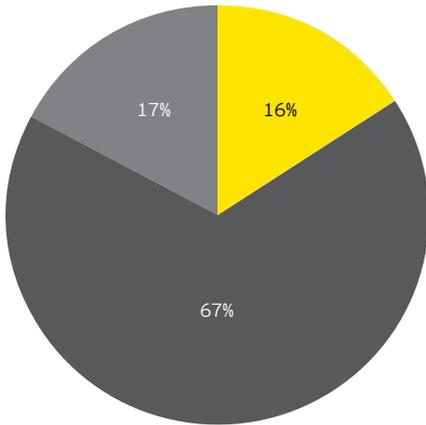
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Responding to BEPS

The OECD's BEPS initiatives inspired and catalyzed such actions as the European Commission's anti-avoidance initiative and country-level changes around the globe such as the diverted profits tax (DPT) policies in the UK and Australia. However, as EY Global Transfer Pricing Technology Leader Ronald van den Brekel explains, "The survey suggests that businesses are not reacting as quickly as they should be to key BEPS provisions."

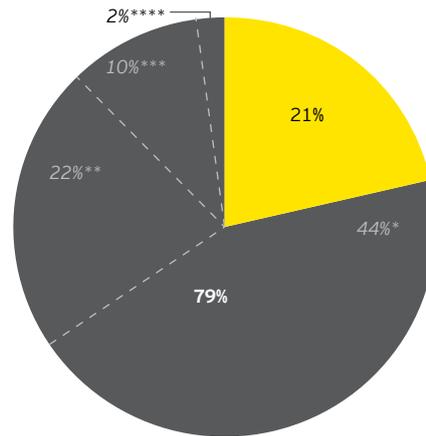
For example, just over half of respondents (51%) say that they have yet to implement global documentation, a requirement related to BEPS Action 13. Meanwhile, two-thirds of companies (67%) say that their documentation processes align with the BEPS format on a limited basis, for key countries and transactions only. European- and Asian-based respondents reported the highest levels of readiness, while Japanese, Australian and America-based respondents lagged.

To what extent does your current global documentation process align with the BEPS format?



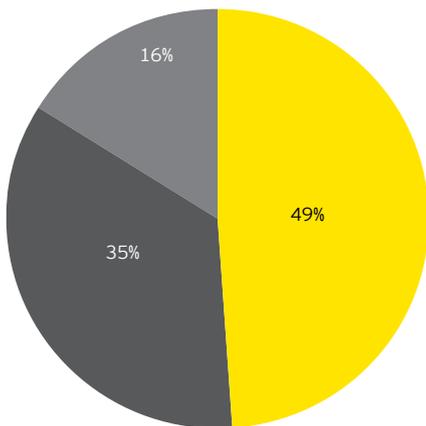
- Entirely
- Key transactions of key territories only
- Not at all

Which of the following best describes your compliance with transfer pricing documentation?



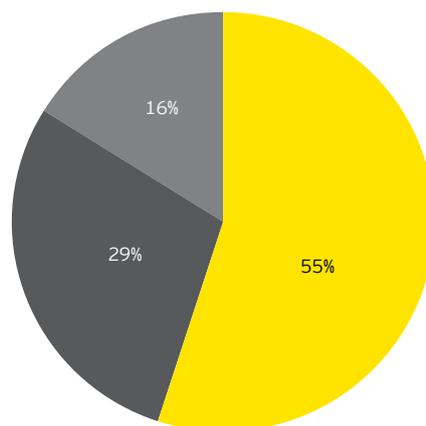
- One-fifth compliant
- Noncompliant
- *Compliant only where transfer pricing is deemed high risk
- **Adapt master file only as needed
- ***Procure documentation only in the case of an audit
- ****Other

To what extent are you planning to implement a global documentation process aligned with the BEPS master file and local file format?



- Not at present
- Next year
- Already implemented or in progress

Are you satisfied or dissatisfied with your global documentation process?



- Not applicable
- Dissatisfied
- Satisfied and would use again

“While countries are moving at different speeds to implement BEPS recommendations, most are moving quickly to enact CbCR and additional transparency requirements,” says Alex Postma, EY International Tax Leader. “Companies who aren’t ready to meet those standards in an aligned manner and with consistent fact patterns will find themselves facing additional scrutiny about their transfer pricing practices.”

Overall, the movement toward achieving fully BEPS-compliant documentation is slow, and is currently being done only on an as-needed basis. For example, only one-fifth of respondents say their group is fully compliant with transfer pricing documentation rules, a finding consistent across respondents from major geographies (23% in the Americas; 19% in Europe) though falling to 6% in Japan.

Of these, the majority say that they are fully compliant only in those instances where transfer pricing is deemed high risk (44%), or adapt their master file only on an as-needed basis (22%), or procure documentation only in the case of an audit (10%).

Interestingly, among those reporting “fully compliant” or “compliant in instances of high risk only,” the majority (52%) are dissatisfied with the process followed in developing their documentation. In fact, only one-third (32%) say they are satisfied and would follow the same process again. One oft-cited reason is “that documentation is being prepared centrally; however, this means that it can lack the sort of detail that allows it to respond to an audit. If a company is going to go to the trouble, they may find it best to invest to make it sufficiently robust in the first pass,” according to Curt Kinsky, EY Asia-Pacific Transfer Pricing Leader.



“This will create challenges because multinationals have been developing their in-house treasury capabilities, which has escalated the volume of intercompany loans, guarantees and cash pooling. There is also now the increased focus to contend with the level of return associated with financing activities as part of key development activities.”

– Danielle Donovan

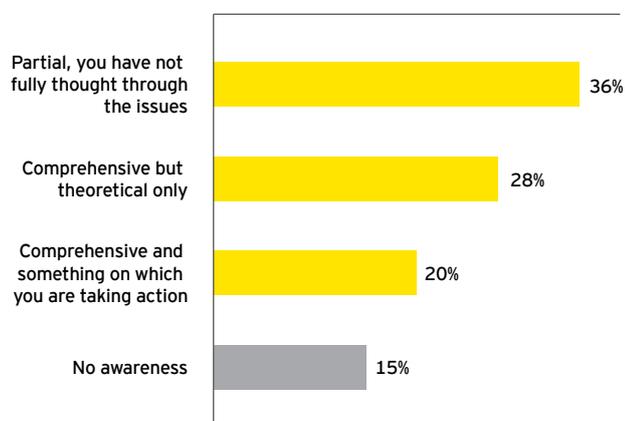
EY Asia-Pacific Financial Services
Transfer Pricing Leader

Growing permanent establishment and intangibles risk

A key feature of BEPS Action 7 is expanding the range of structures and activities a host nation can use to assert a PE.

Not surprisingly, over the next two years, respondents anticipate resulting PE controversy in areas such as the use of sales agents or commissionaires (23%), the level or method of profit attribution (23%) and service PEs (19%), to name the most frequently cited reasons. Overall, about one-third of executives (36%) say that their awareness of PE-related BEPS impacts is merely partial and that they have not worked through the relevant considerations; 15% say that they have no awareness of Action 7 whatsoever. Only one in five businesses (20%) have taken comprehensive, BEPS or PE-specific actions.

Would you describe your awareness of the materials published in connection with BEPS Action 7 as ... ?



Numbers may not sum due to rounding

BEPS Actions 8-10, meanwhile, focus closer attention on the tax treatment of intangibles. In particular, there is an emphasis on taxpayers demonstrating the substance behind intangibles-driven fees and revenues, with a strong emphasis on where economic or beneficial IP ownership could be seen in place, and clear movement away from the notion of legal ownership.

“To value earnings from intangibles and intellectual property, BEPS shifts from the current focus on legal ownership, risk bearing and financing, and instead probes the value driven from five core activities,” says Griffin, who is also Americas Transfer Pricing Leader. Denoted by the acronym DEMPE, the activities include “development, enhancement, maintenance, protection and exploitation.” This shift, says Griffin, “means that more companies will now need to take more wide-ranging steps to evaluate and justify their intangibles-based transfer pricing, and why or how this aligns with the outcomes generated.”

It is also worth noting that, having unfettered access to more information about any given individual taxpayer’s global operations, revenue authorities are both more motivated and more confident that their actions can result in closing adjustments. As a result, jurisdictions are more likely to become more active.



“To value earnings from intangibles and intellectual property, BEPS shifts from the current focus on legal ownership, risk bearing and financing, and instead probes the value driven from five core activities.”

– Peter Griffin
EY Global and Americas
Transfer Pricing Leader



“As the indications from the results of several related questions suggest, BEPS readiness across the board may not actually be at the level indicated.”

– Ichiro Suto

EY Japan Transfer Pricing Leader

Operationalizing transfer pricing: do firms have the capabilities they need?

Amid so much change, companies need to be more proactive regarding their transfer pricing strategies and practices. But a closer examination of the mechanics of operationalization indicates that company needs or desires tend to exceed grasp.

For example, the survey shows that one out of five respondents (21%) say that their organizations lack operational readiness to adapt to changing transfer pricing conditions. But that figure is likely understated, according to Ichiro Suto, EY Transfer Pricing Leader for Japan. “As the indications from the results of several related questions suggest, BEPS readiness across the board may not actually be at the level indicated.” As flagged earlier, for example, slightly more than half (52%) say they are dissatisfied with their global documentation process. Just one in five (21%) say that they are fully compliant in every country they operate in. Perhaps of even greater concern, only 44% say they are fully compliant even in those countries where they perceive transfer pricing to be high risk. A similar lower level of awareness was also evident in responses related to PEs.

And many are still struggling strategically – 73% of respondents still monitor their transfer pricing results on a merely quarterly or annual basis. And nearly half lack the automation necessary to detect deviations that could lead to true-ups in real or near real time, and therefore, avoid cumbersome manual adjustments that can lead to errors and lumpy results in ensuing periods.

A close look at priorities merely heightens these concerns. Seven out of 10 companies (69%) consider establishing a clear vision and strategy as their top priority (only 60% in life sciences but consistent across other industries). However, only about half this many (35%) describe their associated state of maturity to do so as high; the bulk are merely at “medium” (50%). This indicates that there is work to be done.

The same can be said for nearly all additional priorities in operationalization of transfer pricing. The second and third priorities are establishing data quality and accuracy followed by integration with business operations and reporting environments. Fourth, fifth and sixth places are, respectively, developing policies, procedures and processes; building cross-functional teamwork; and technology enablement and automation. As with the top priority of strategy formulation, significantly more companies state the need to focus on these issues than the number describing their capabilities as up to the task.

There are a number of significant differences by industry. For example, only 50% of insurance participants rank clear vision and strategy as their top priority (vs. 69% overall), while technology enablement and automation climbs to 40% (vs. 23% overall). Meanwhile, in life sciences, though clear vision and strategy is the top-ranked selection, this sector ranks skills, capabilities and training as its number two operational priority.

As for the most difficult challenges in transfer pricing administration, process and governance, nearly half of companies (49%) bemoan their lack of automation, resulting in highly manual processes. Nearly similar numbers (44%) point to the documentation necessary to support tax authority audits as problematic. Other challenges include inconsistency in associated processes across the enterprise, lack of alignment with the business operating model and inadequate monitoring controls. On an overall basis, this points to there still being high levels of risk regarding reporting outcomes, and a continued gap in the desired state when compared to reality.

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%

What issues have the biggest operating impact on your transfer pricing process?



Multiple responses allowed



How businesses should respond

We believe transfer professionals should take concrete actions to adapt to this new, riskier, post-BEPS world. Here are five immediate next steps to consider.



► **Refresh the assessment of your transfer pricing risk profile**

As the changing transfer pricing environment unfolds, existing models may fall foul of new rules. Identifying where risk lies allows you to best understand and determine an approach to limit the risk of audit activity arising.



► **Update your risk limitation and compliance activities**

New strategies and actions are not optional – they’re required. This can range from enhancing your documentation package to modifying your transfer pricing model to supplementing the level of substance in relevant locations. To protect your IP structure, steps such as these will best position you to substantiate your transfer pricing framework, given the likely lines of challenge that will arise.



► **Develop a broad audit plan**

The risk of audits, worldwide, is rising. Responding on an ad hoc, inconsistent basis in an era of greater information sharing will lead to inconsistent outcomes, and may undermine your position in other jurisdictions. Having a plan in place will allow you to know how to best respond in a way that doesn't undermine your overall model. Note that where tax risks are especially pronounced, executives should take another look at bilateral or even multilateral APAs. Though these can take some time and effort to lock into place, they can reduce headaches further down the road.



► **Revisit PEs**

Do not overlook the emerging threat of PE challenges. If you end up in a position where under today's tighter rules a PE is asserted, this can potentially have a significant effect on your tax profile. Remember that the thresholds have been tightened, and what was previously outside the scope may no longer be.



► **Realign transfer pricing and IT systems**

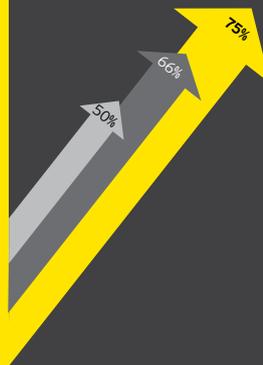
Finally, evaluate the available tools to align your transfer pricing and IT or reporting systems. Relying on periodic, ad hoc manual adjustments to effectively implement your transfer pricing model has a high level of risk of errors, while post-period adjustment will see financial statements not reflecting the anticipated outcomes for a particular period. This will at a minimum increase the level of inquiry into how the transfer pricing model has been applied, which has the potential time and cost impacts from spilling over into a wider audit.

Conclusion

Unquestionably, companies will need to become comfortable with sharing more tax data with authorities far and wide. More jurisdictions having unfettered access to more data will lead to heightened focus on transfer pricing and greater risk of controversy.

Recognize also that in this era of increased transparency, reputational risk is increasingly at stake. Companies might even want to consider sharing more, not less, tax information. To the extent an enterprise can do a more thorough job in educating the public and other stakeholders about the contributions made via tax, it may be able to turn a potential negative into a strong positive.

In today's global economy, any company that uses pins and thread to visually depict its transfer pricing operations would end up with a colorful picture. But the craft is under increasing pressure; it is important to check the connections to be sure the thread is not fraying. Because in the future, there's going to be more scrutiny than ever of how your transfer pricing model aligns with your operating model.



The number of firms indicating “tax risk management” as their top transfer pricing priority has surged to

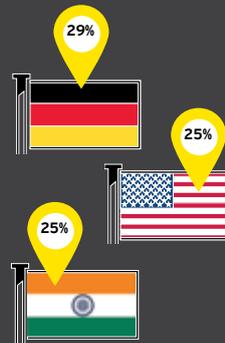
75%

up from 66% in our 2013 survey; in 2007 and 2010, that proportion was just 50%.



39%

most frequently cited greater enforcement as the tax risk factor driving transfer pricing strategies today.



The top three most frequently cited nations where transfer pricing policies have faced official examinations are:

29% Germany

25% US

25% India



The survey shows that one out of five respondents

21%

say their organizations lack operational readiness to adapt to changing transfer pricing conditions.

Survey highlights



Just one in five respondents
21%
say they are fully compliant in every country.



Seven out of 10 companies
69%
consider establishing a clear vision and strategy as their top priority.



73%
of respondents still monitor their transfer pricing results on a merely quarterly or annual basis.



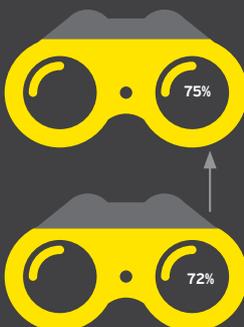
As for the most difficult challenges in transfer pricing administration and governance, nearly half of companies
49%
bemoan their lack of automation resulting in highly manual processes.



Just over half of respondents
51%
say they have yet to implement global documentation, a requirement relating to CbCR.



67%
of companies say their documentation processes align with BEPS formatting on a limited basis, for key countries and transactions only.



72%
of companies indicate that their transfer prices have been a core focus of past controversy, whereas **75%** expect this to be the case going forward.

Methodology

The survey was conducted between April 2016 and June 2016. The survey was distributed via email and conducted using an online tool in English, Russian and Japanese; 85% of respondents chose to complete the survey in English. Routine reminders were sent out to respondents who had not completed the survey. Once an adequate number of responses had been recorded, the survey was closed. Any survey with 75% or more of the questions answered was considered complete for analysis purposes. The respondents included 623 tax and finance executives representing more than 17 industry sectors in 36 countries. Figures contained in the report may not add to 100% due to rounding, non-reporting of "don't know" responses, and no responses. Questions with fewer than five respondents are not reported in the interest of data confidentiality.

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