



How profound change, transparency and controversy are reshaping a critical business function

2019 Transfer Pricing and International Tax Survey

The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. A yellow triangle is positioned above the 'Y', pointing to the right.

Building a better
working world

Editorial

Why changing transfer pricing practices requires a proactive approach **1**

Key findings

What findings show about growing risk and controversy in transfer pricing **5**

Chapter 1

Five strategies for responding to change in global transfer pricing **9**

Chapter 2

How to prepare for a rise in tax controversy related to transfer pricing **17**

Chapter 3

How a global tax reform “revolution” will affect transfer pricing **27**

About the survey

Since 1995, we have taken the pulse of global transfer pricing every two to three years by collecting and analyzing details on attitudes and experiences across a wide spectrum of taxpayers.

The 2019 survey was conducted between March 2019 and June 2019. The survey was distributed via email and conducted using an online tool in English, Spanish, Portuguese, Chinese and Japanese; 87% 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 completed responses past the sixth of ten sections of the survey was considered complete for analysis purposes.

The respondents included 717 tax and finance executives representing more than 20 industry sectors in 43 jurisdictions within the Americas, Europe and Asia-Pacific.

Figures contained in the report may not add to 100% due to rounding. The report also excludes “don’t know” responses and questions for which no response was given. Questions with fewer than five respondents are not reported in the interest of data confidentiality.

Why changing transfer pricing practices requires a proactive approach

Welcome to the *2019 Transfer Pricing and International Tax Survey: how profound change, transparency and controversy are reshaping a critical business function*.

Since 1995, we have taken the pulse of global transfer pricing (TP) every two to three years by collecting and analyzing details on attitudes and experiences across a wide spectrum of taxpayers. For 2019, this includes over 700 responses from senior tax and transfer pricing executives representing the Americas, Europe and Asia-Pacific.

Past surveys have been highly effective in identifying key trends along with their associated risks and opportunities. In the 2016 edition, for example, we explored how developments, such as the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) initiative, were forcing global businesses to come to terms with unprecedented levels of transparency about their operations.

Exponential change

For 2019, the survey results show degrees of change and transparency, already at high levels, are accelerating almost exponentially. As a result, executives are indicating that since the pace of change is so rapid and the degree of expanded transparency is now so pronounced, a wave of tax controversy is imminent.

The first round of BEPS was a key catalyst, sparking new legislation all over the world. And while many of those legislative changes seek to mirror the spirit of BEPS, a number of new laws inspired by BEPS deviate enough from the original recommendations that inconsistencies and uncertainties are growing. This is happening even as executives scramble to keep themselves up-to-date.

But if BEPS was the catalyst, then the [follow-on global project facilitated by the OECD](#) on changing the division

of taxing rights that is triggered by the digitalization of the economy is the accelerant. With the ink still drying on many legislative changes prompted by BEPS, an even more fundamental revisit of the international tax norms is underway. While the core focus of BEPS was to strengthen the existing division of taxing rights by introducing, among other things, more transparency to standardize global transfer pricing practice, the new project is more fundamental.

In general, the current OECD project seeks to transition transfer pricing from its location-dependent origins to a more fluid digital model. Accomplishing this begins by acknowledging the existence of income allocation, in particular, enabling host taxing authorities to tax digital cash flows. The project also includes development of new global minimum tax rules, although in this case, tax reforms in the US, UK, France and Australia are already enacting them. And where BEPS arguably chipped away the time-honored use of the arm's-length standard for establishing transfer pricing, the follow-on project appears to be taking a significant swing.

“

The implications reach far beyond just sectors that identify as ‘digital’ to include nearly every kind of cross-border enterprise.

Executives should also be paying close attention to the expansion of cooperation between global tax authorities. In the transfer pricing space, adjustments made by one tax authority are increasingly likely to be replicated by others due to joint enforcement efforts and exchange of information. In general, the tax world is moving to an era of multilateral policy and administration, which is causing important shifts in the practice of transfer pricing.



Forging a response

This leads to what executives believe will be an upswell in the depth, breadth and frequency of challenges to transfer pricing (Chapter 1: *Five strategies for responding to change in global transfer pricing*) and controversy (Chapter 2: *How to prepare for a rise in tax controversy related to transfer pricing*). Specifically, executives anticipate significantly more instances of audits, fines and assessments, and recognize the need to respond.

But what can companies do in this environment of heightened change, transparency, controversy and, in general, skyrocketing tax risk?

- ▶ **Alert the C-suite:** Perhaps most importantly, executives need to better prepare their C-suite and boards for the degree of change, transparency and, ultimately, controversy that is about to reach a crescendo. Make certain also that such executives recognize the changes will impact not only transfer pricing, but also the fundamentals, such as permanent establishment (PE), withholding rates, controlled foreign corporations (CFCs) and treaties, and even new rules for taxation of short- to medium-term business travelers.
- ▶ **Get connected:** In general, companies need to do more to ensure they are up-to-speed in relevant jurisdictions. That means understanding the existing changes in rules and practices as well as what's likely coming soon. Companies also need to do more in terms of being ready with contemporaneous documentation of their transfer pricing. Being ready, companies can respond more quickly and confidently to audit requests and, in this way, generally reduce the risks of assessments or worse.
- ▶ **Participate in the shaping of legislation:** In addition, more companies need to step up and play a more active role in the development of tax policy. The pace of change is increasing tax risks. As such, more companies, once they take a closer look, might find that their levels of risk and cost are now beyond any threshold where they can afford to simply sit back and wait for rules to take effect.
- ▶ **Use Advance Pricing Agreements (APAs) to reduce uncertainty:** More businesses should also be considering the use of bilateral (and increasingly multilateral) APAs. One of the most frequently cited reasons for not doing so in the past has been the perception of extensive disclosure requirements and, with that, high cost. But demand for APAs is growing. Many say that with the BEPS-driven expansion of transparency, the required disclosures for an APA are not all that much greater than what is already being required in a basic return. Indeed, the survey shows a significant uptick in expectations for the use of APAs.

- ▶ **Revisit global models and strategies:** The degree of change is so significant that companies need to take a fresh look at the entirety of their operating model and strategies. Sweeping changes, like what the United States undertook in enacting the US Tax Cuts and Jobs Act (TCJA), will become even more commonplace. Momentum for the changes being developed through the current OECD project is building. Bottom line: more nations will be embracing new principles, such as a global minimum tax or new rules for the taxation of intellectual property. Even though much is still unknown, businesses need to get moving now to understand how such fundamental changes will impact their operations.
- ▶ **Adopt a strategic approach:** Once informed of this heightened risk, more companies will be willing to take a greater strategic approach to transfer pricing. That is, they can step back, look at the whole of their global footprint to assess how and where value is being created. From there, rather than using transfer pricing to deal with outcomes, businesses themselves can be restructured to create a sustainable state of affairs. Transfer pricing that is rooted in operational reality and globally consistent will prove to be defensible to tax authorities and in that way, even amid an era of heightened controversy, represent the absolute lowest levels of tax risk.

While I have contributed to our previous Transfer Pricing surveys, this is my first time as editor. With this edition, we expanded the scope to include a broader array of questions about international taxes, including a section exploring taxpayer attitudes about the Mutual Agreement Procedure (MAP) program. That's because the business of transfer pricing and international tax more broadly are increasingly interdisciplinary and so should be examined through that lens. I hope you agree this broadened scope has helped us deliver more insights to this survey report.



Peter Griffin

Peter Griffin
EY Global Transfer Pricing Leader



What findings show about growing risk and controversy in transfer pricing

The survey demonstrates executives are recognizing they need to begin taking a more fundamental and strategic approach to transfer pricing. Key steps include elevating the role of the function as well as working with business units to refine core transfer pricing strategy and develop compelling contemporaneous documentation. Summarizing key insights, the research shows:

Transfer pricing

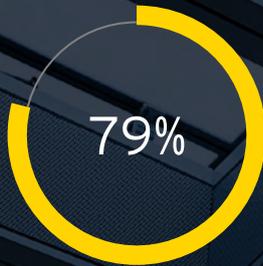
- ▶ Among survey respondents, 8 out of 10 executives (79%) describe today's international tax environment as "uncertain," 40% very much or extremely so.
- ▶ Tax risk is by far the most critical issue driving respondents' transfer pricing strategies (64%).
- ▶ Ranking issues of greatest importance, relative to tax risk, the top three are increased information sharing among tax authorities, information being made public or reputational risk and a relative lack of centralized and consistent control in responding to tax authorities.
- ▶ Only a third of the companies maintain contemporaneous documentation of transfer pricing for each country of operation, 45% do so only for high-risk jurisdictions and 22% only "as needed."
- ▶ Companies recognize that their transfer pricing documentation is due for an overhaul, with only 11% indicating high satisfaction with their current global transfer pricing documentation process.
- ▶ Only about one in five (22%) see the documentation process as a strategic opportunity to clearly articulate transfer pricing strategy.
- ▶ Fewer than one in five companies (19%) manage their transfer pricing matters solely in-house, 48% outsource or co-source to a single external provider and 33% handle theirs with (or by giving it to) one or more providers.

Controversy

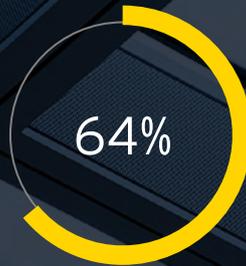
- ▶ Forty percent say that challenges to transfer pricing over the past three years have led to double taxation.
- ▶ By far, the areas deemed most critical in terms of tax controversy in the past include:
 - ▶ Transfer pricing of goods (64%)
 - ▶ Intragroup financial services (41%)
 - ▶ Value-added tax (VAT) or goods and services tax (GST) (34%)
- ▶ Going forward, survey respondents expect little-to-no change across most focuses, with two highly notable exceptions:
 - ▶ Expectations for challenges to intellectual property (IP) rise to 49% (up from 33%), becoming the second most important issue within tax controversy (up from fourth)
 - ▶ Frequency of mention for expected permanent establishment (PE) controversy nearly doubles from 20% to 39%
- ▶ One in five executives (20%) say that within the past three years, their companies have experienced disputes surrounding PE.
- ▶ Eighty-four percent say their tax departments are becoming proactively involved in responding to evolving tax rules surrounding IP, yet only 29% say their businesses are working to identify or bring about value-creating IP.
- ▶ To reduce tax risks, 37% of companies are currently using an Advance Pricing Agreement (APA).
- ▶ In terms of satisfaction with APAs, 57% of respondents say they are either very satisfied (18%) or satisfied (39%).
- ▶ Going forward, 43% say they will be significantly more likely to use an APA.
- ▶ Only one in five (20%) of companies have requested competent authority assistance; but only 15% of these say they have confidence in the process.

Key findings

Today's international tax environment: uncertainty prevails



of executives describe today's international tax environment as "uncertain"



say tax risk is by far the most critical issue driving transfer pricing policies



of respondents say the need for alignment with management or operational objectives also plays a role in transfer pricing decisions

Double taxation: an already significant issue



have experienced challenges to their transfer pricing over the past three years

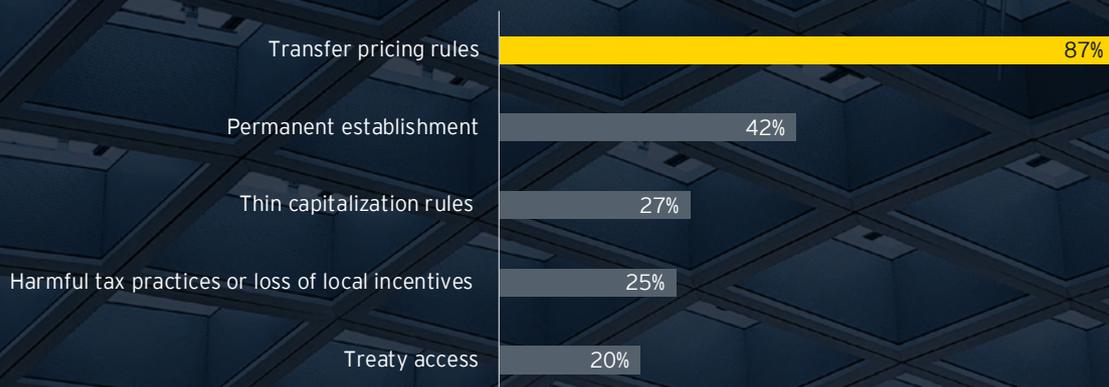


say that challenges to transfer pricing have led to double taxation



rate TP documentation as an opportunity to clearly articulate TP policy

Overall, respondents say the greatest impacts of global tax reform will be felt in fundamental transfer pricing rules, the second and third key areas of impact are permanent establishment (PE) and thin capitalization rules



Global tax reform

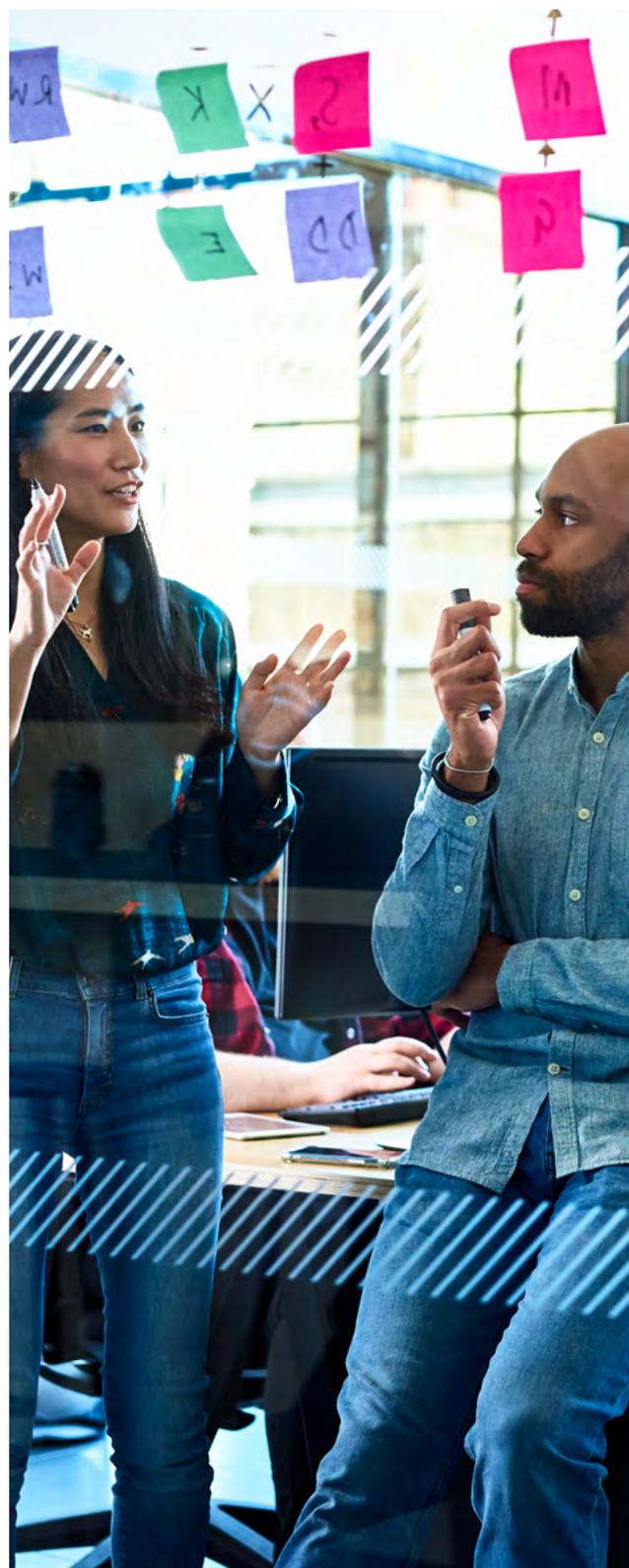
- ▶ Overall, respondents say the greatest impacts of global tax reform will be felt in fundamental transfer pricing rules.
- ▶ The second and third key areas of impact are PE and thin capitalization rules.
- ▶ When asked to force rank the area of operations that is most impacted by global tax reform, the most frequently cited business component was supply chain (41%), followed by treasury operations and then IP strategy – albeit with significant regional variation.
- ▶ Worldwide, only 16% say the US Tax Cuts and Jobs Act (TCJA) is significantly impacting their tax decisions, with the figure climbing to 35% for US companies.
- ▶ Few businesses, regardless of geography, are reporting significant changes in behavior as a result of the US Foreign Derived Intangible Income (FDII) regulations.
- ▶ Only a small minority (12%) say they have combed through all the changes amid global tax reform, developed models and formulated a response, with the remainder exhibiting wide-ranging states of readiness.

“

The tax world is moving to an era of multilateral policy and administration, which is causing important shifts in the practice of transfer pricing.



Peter Griffin
EY Global Transfer Pricing Leader





Five strategies for responding to change in global transfer pricing

“

It is an era of profound transfer pricing change, transparency, uncertainty and risk.



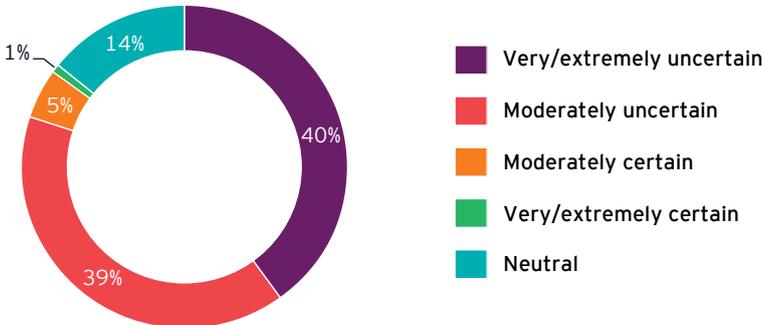
Luis Coronado
EY Asia-Pacific Transfer Pricing Leader

This installment in the coverage of the 2019 *Transfer Pricing and International Tax Survey* documents respondent sentiments that global tax risk is on the rise and examines a handful of fundamental opportunities for redress.

Uncertainty prevails

Eight out of 10 executives (79%) in our new transfer pricing and international tax survey described today’s international tax environment as “uncertain,” 40% very much or extremely so.

How survey respondents perceive uncertainty of the current international tax environment



If anything, according to EY transfer pricing-focused executives, the environment is even riskier than the survey data suggests. “Significant episodes of tax reform are taking place worldwide,” says Ronald van den Brekel, EY EMEA Transfer Pricing Leader. “BEPS and the follow-on OECD project have driven and continue to drive significant changes in strategies and services.”

Van den Brekel says that even though what the OECD intended with BEPS was to facilitate greater consistency across taxing jurisdictions, there are many examples of national authorities taking a unilateral approach or interpreting BEPS in a unique way.

Luis Coronado, the EY Asia-Pacific Transfer Pricing Leader, agrees. “People are already experiencing considerable

changes in areas such as increased transparency within BEPS,” says Coronado. But now, the OECD is advancing the discussion further. “New proposals seek to update tax policies for the digital age, exploring ideas for reallocating profits by new yet undetermined means, such as on a revenue basis.”

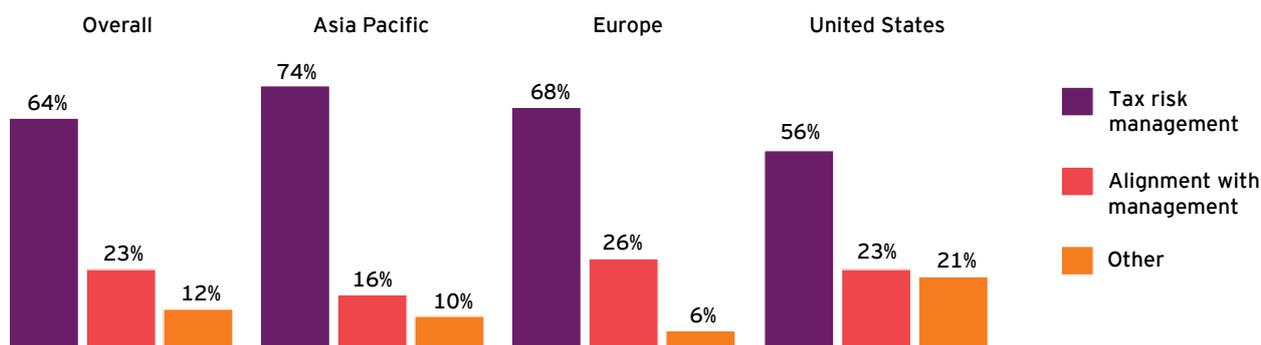
In addition, “there are new proposals to reduce the advantages created by locating in low-tax jurisdictions through the creation of a global minimum tax – following the lead of the US, whose TCJA introduced this concept within international taxation.” Overall, says Coronado, “this is a fluid global transfer pricing tax environment, one where many traditional principles are being re-evaluated, and it demands that companies become more engaged.”

Transfer pricing: the focus is risk

Shifting global tax rates and rules, and the need to adjust to heightened transparency are all contributing to increased tax risk. Indeed, tax risk is by far the most critical issue driving respondents' transfer pricing strategies. This is the case for 64% of respondents overall, but with a distinct variance by geography.

Behind risk avoidance, 23% of respondents say the need for alignment with management or operational objectives also plays a role in transfer pricing decisions.

Tax risk is the highest priority driving respondents' transfer pricing policies



In terms of specific forms of tax risk, the survey asked respondents to rank those most influential in forming their tax policies and strategies. Applying weighted scoring for their first, second and third choices results in an overall ranking of:

- ▶ **First:** Information sharing among tax authorities
- ▶ **Second:** Information being made public and reputational risk
- ▶ **Third:** Lack of control to respond to tax authorities

Beyond these top three rankings, significant numbers of executives also pointed out:

- ▶ **Fourth:** Lack of technological readiness
- ▶ **Fifth:** Stricter enforcement
- ▶ **Sixth:** Lack of execution over transfer pricing policy

This overall ranking demonstrates several key elements of today's transfer pricing decisions. "For one, it shows that companies today are well aware that with more information sharing, they have to realize they are operating in an era of unprecedented transparency and that their transfer pricing approaches have to reflect this," says van den Brekel. Hand in hand with this realization, "more companies are now focused more than ever on avoiding risk by assuring they are in compliance with an array of rapidly changing rules and regulations."

Van den Brekel also notes that companies are realizing that their local tax teams are not always well equipped to respond to inquiries or audits. "The local focus tends to be on basic compliance," says van den Brekel. For this reason, he explains, "we feel more companies have to make certain they have controversy-ready documentation in place so that they can respond promptly when any questions arise. This is becoming even more critical in today's transfer pricing environment."

Issues influencing transfer pricing approach vary by region

The Asia-Pacific list	The European list	The US list
1. Information being made public/reputational risk	1. Lack of control to respond to tax authority inquiries	1. Information sharing among tax authorities
2. Stricter enforcement	2. Information sharing among tax authorities	2. Stricter enforcement
3. Information sharing among tax authorities	3. Lack of technological readiness	3. Information being made public/reputational risk

Forging a response

The degree of change is profound – meaning businesses must respond. Some of the key opportunities indicated by the survey results and accompanying interviews include:

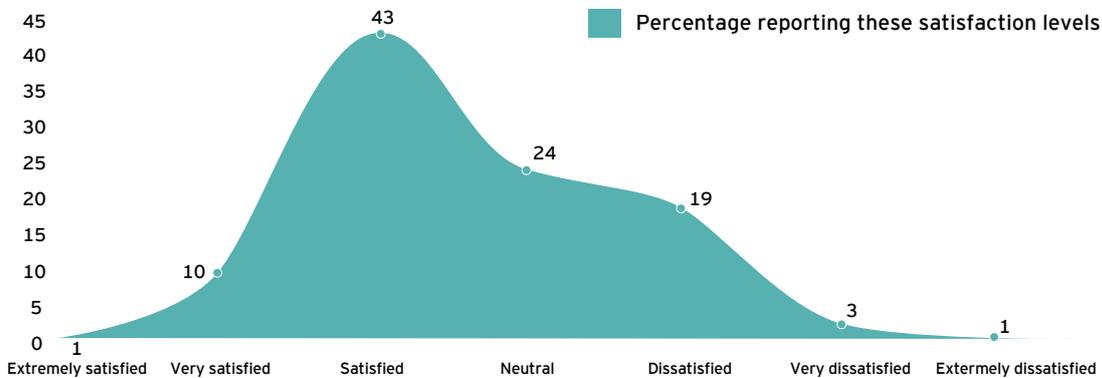
Opportunity number one: Become more engaged

As if BEPS isn't ushering in enough change, businesses today must also contend with the more fundamental changes now being developed in the OECD's subsequent wave of global tax reforms as well. Coronado observes that where BEPS was the handiwork of members primarily from the G-20 and OECD, "there are at least 130 jurisdictions participating in" the new discussions.

Consequently, says Coronado, businesses cannot afford to sit idle. Those with the most complex or highly digital business models with significant intellectual property "need to get engaged and make sure they review, carry out calculations on the options presented and are commenting on the reports and drafts as they come available – i.e., they must provide feedback and become intimately involved."

At the very least, continues Coronado, companies need to begin modeling how new concepts and rules might affect their business arrangements and tax results. Businesses, says Coronado, "may not have complete information as of now, but they have enough to evaluate what they would need to do under option A versus B versus C."

Executives express low levels of satisfaction with transfer pricing documentation process



Opportunity number two: Elevate the activity

Survey respondents recognize that their transfer pricing documentation is due for an overhaul. In fact, only 11% indicate solid satisfaction with their current global transfer pricing documentation process. One of the reasons for this lack of satisfaction could be that too many businesses are approaching transfer pricing from a compliance perspective rather than taking a holistic approach. When asked about where the purpose for their documentation falls within the scale from wholly compliance-focused to wholly strategic, only 22% rated theirs as an opportunity to clearly articulate their transfer pricing policy. Nearly identical numbers, 21%, line up at the opposite or compliance-focused end of the scale, rating themselves a 1 (11%) or 2 (10%). The remaining 58% all line up in the middle, creating a classic bell curve.

Van den Brekel maintains that companies whose transfer pricing focus leans toward mere compliance are missing out on a strategic opportunity. Amid so much change, “a strategic review of worldwide TP policies can lead to enormous benefits,” he continues. Working hand in hand with finance, operations and other executives, “companies will be able to better understand their situation and create a more optimized and consistent approach.”

Moreover, says van den Brekel, “companies will then have a very clear and well-documented explanation to share with global tax authorities. And so, they will be able to improve the quality of their transfer pricing policies, while reducing their tax risks.”

Opportunity number three: Expand documentation efforts

Companies doing business across borders recognize that contemporaneous documentation of a well-conceptualized and consistent across-the-globe transfer pricing structure is essential to reducing tax risk. “By having your ‘documents’ ready, you can respond more rapidly and competently,” says Coronado. “This signals to authorities that you’ve put your time in on the issues and have used a consistent framework.”

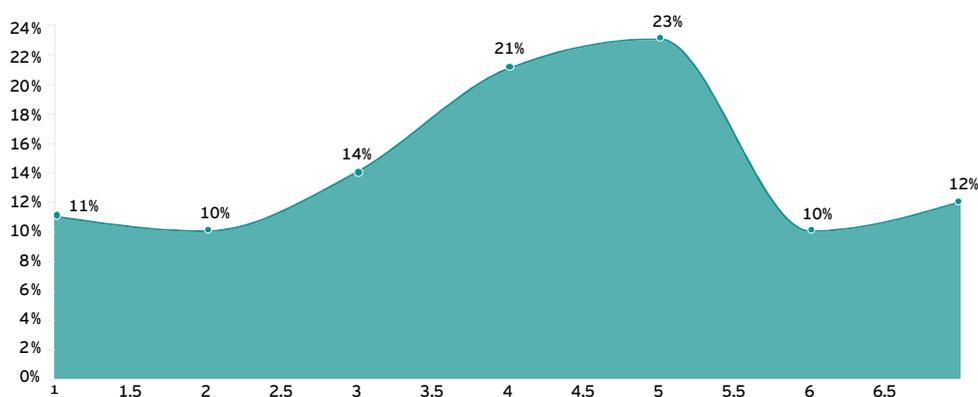
Tax officials, seeing such a speedy, confident and well-documented response, “are more likely to accept a company’s circumstances and explanations and, therefore, be less likely to enact adjustments or pursue any deeper dives,” says Coronado.

Nonetheless, only one-third of executives say their companies stand ready with fully compliant transfer pricing documentation in every country in which they operate – a figure consistent across geographies. The figure is similarly consistent across industries, though it is rising to 43% in financial services; falling to 21% for diversified industrial products; and, again, rising to 52% among companies with more than 10 full-time equivalents (FTEs) in transfer pricing.

Instead, it is significantly more common for businesses to place a particular focus on ensuring their transfer pricing practices are well documented in those countries viewed as having higher tax risk – an approach used by 45% of executives. The figure is consistent across geographies and industries, except for automotive and transportation, where it climbs to 55%.

Most companies need a holistic approach to transfer pricing

Proportion of respondents identifying approach to transfer pricing documentation



Percentage reporting: 1 = Compliance only/minimum required documentation; 7 = Opportunity to clearly articulate transfer pricing rationale

The remaining 22% of executives say they do not proactively document, but instead adapt a master file as necessary (16%) or develop documentation upon audit request only (5%) or "other" (1%).

Such a risk-focused approach "is understandable in many cases," says EY Global International Tax Services Policy Leader Marlies de Ruiter. "It makes sense that companies would want to focus their resources on the areas of greatest risk." However, de Ruiter continues, "with the overall levels of transfer pricing-based tax risk on such a steep rise, it's most definitely the right time to revisit those thresholds. Tax risk is increasing almost across the board.



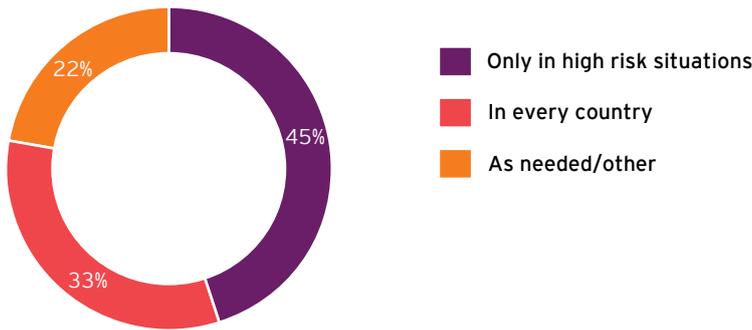
Companies should be taking steps to ensure they have their documentation ready to go across a much wider swath of their global footprint.



Marlies de Ruiter
EY Global International Tax Services Policy Leader

As tax risks rise, more companies need to address documentation

Proportion of respondents describing compliance with transfer pricing documentation requirements



Opportunity number four: Embrace technology

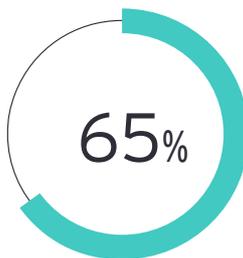
Technology presents another opportunity for improving transfer pricing policy and execution. Today, says Tracee Fultz, EY Americas Transfer Pricing Leader, "most companies use text documents and spreadsheets as their primary tools." Only about a quarter of the businesses have more integrated technologies at their disposal for purposes of transfer pricing documentation.

Tax departments have yet to embrace technology

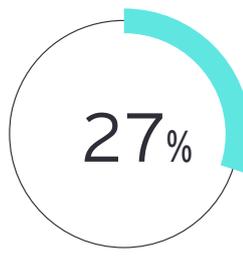
Text documents (e.g., Word)



Spreadsheets



Integrated technology



A wide array of companies today are working toward digitalization of their core businesses and support functions such as finance and taxation. Meanwhile, tax authorities themselves are becoming more automated – with a fast-growing number of jurisdictions moving toward digital, real-time filing of basic value-added tax (VAT) or good and services tax (GST) transactions will eventually shift toward e-filing and e-audits.

Tax departments themselves, says Fultz, “will find it worthwhile” to embrace new technologies. Software today, she explains, “can be used for purposes such as monitoring transfer pricing margins or keeping track of services charges.” Tools, such as robotic process automation (RPA), can be employed to lighten workloads, reduce errors and free greater resources for more value-added pursuits. Armed with more digital tools, “tax departments will be in a much better position for managing and documenting their transfer pricing.”

The adoption of a more centralized, shared services approach to global tax management goes hand in glove with technology. The model to embrace, says Fultz, “is one that is standardized to the full extent possible – where expertise is concentrated, and there is a data lake and the data is captured for a single-time use where and when

needed.” Local finance and tax teams can of course respond to local needs and nuance, but adjustments and changes to processes and reports take place only where necessary.

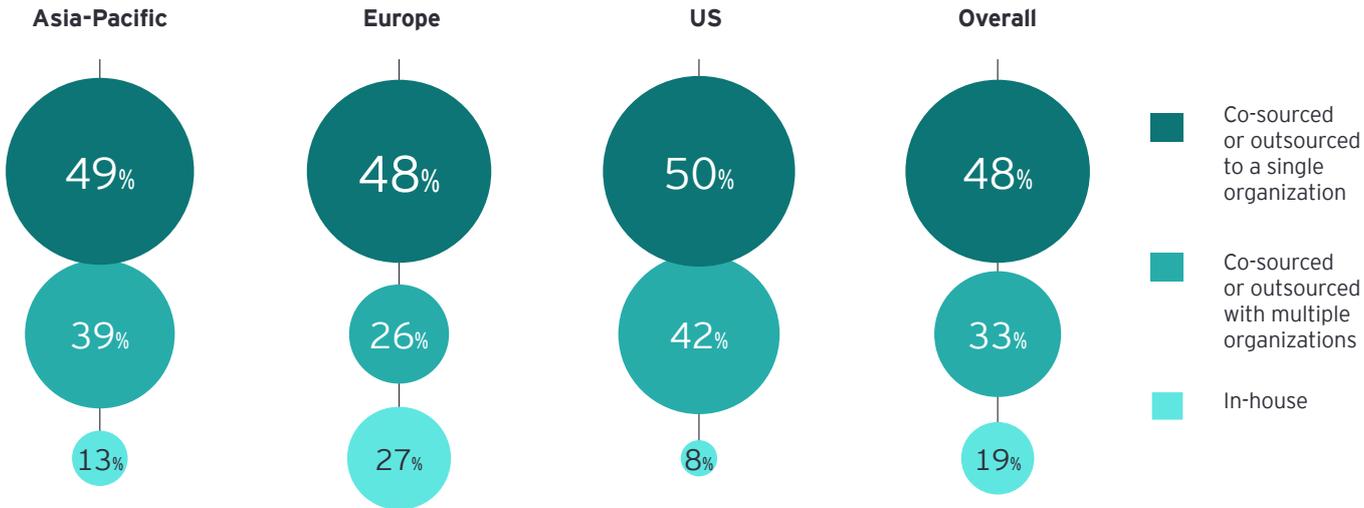
Opportunity number five: Obtain more help

Both van den Brekel and Coronado say that given the degree of change in today’s transfer pricing and general tax environment, businesses need to take a close look at tax department resources. “Do all you can with automation, with RPA and the like,” says van den Brekel. “But ultimately, your tax function is likely under-resourced; there is simply too much change and too many growing demands. Companies always want to do more with less, but here, the risks are growing.”

One means to address any resource gap is to pursue greater outsourcing or co-sourcing. Consistently, about half of all companies, regardless of geography, outsource significant portions of their transfer pricing documentation activities to outside providers. Meanwhile, 27% of European companies say they prefer keeping things in-house, which is twice the figure for Asia-Pacific (13%) and three times that of the US (8%). A final note: US firms are significantly more likely than others to pursue a co-sourced model.



US businesses more likely to co-source transfer pricing documentation than European, Asia-Pacific rivals





How to prepare for a rise in tax controversy related to transfer pricing

In this chapter, while examining our *2019 Transfer Pricing and International Tax Survey*, we continue with survey results and commentary from senior EY executives analyzing the key challenges and opportunities within tax controversy, its avoidance and prevention plus dispute resolution.

“

Right now, for some it may be possible to get by with just an umbrella, but for the storm that is coming, businesses need to begin taking significantly more solid actions.



Marlies de Ruiter

EY Global International Tax Services Policy Leader

Clouds of controversy

Storm clouds have been gathering for tax and transparency controversy for several years. Our 2019 Transfer Pricing and International Tax survey indicates executives are bracing for a monsoon.

“The sense we’re getting from everywhere we look is that tax directors increasingly are already struggling with controversy,” says de Ruiter. But the expected levels of controversy, says de Ruiter, are intensifying. “As today, just about everywhere, we see conditions and circumstances that are likely to drive remarkable numbers of reviews, challenges, audits and double taxation.”

In the survey, 82% of respondents say they have experienced challenges to their transfer pricing over the past three years, with 40% of these saying that the resulting adjustments have led to double taxation.

But according to Tracee Fultz, EY Americas Transfer Pricing Leader, a host of key trends and related developments are pointing to a period in which double taxation and controversy will be central to the day-to-day operations of a tax department. “Fiscal pressures are increasing with jurisdictions all over the world now in competition with one another for revenue,” she explains.

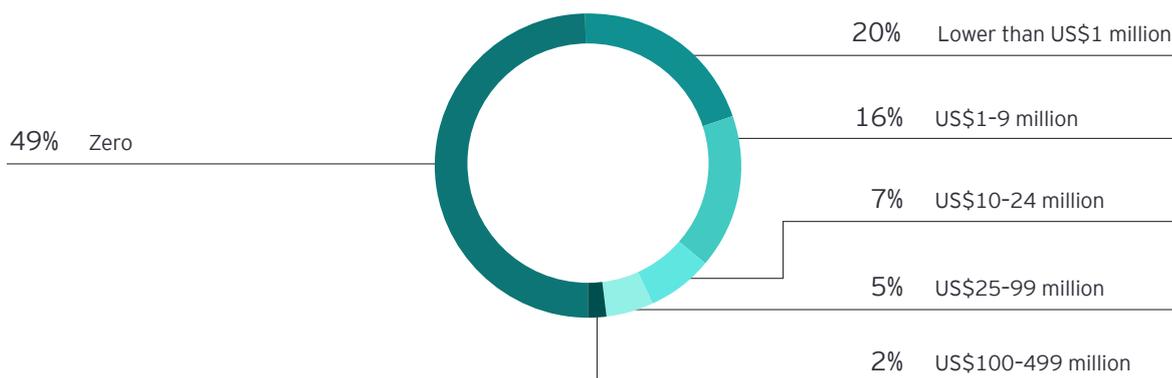
The amount of information now in the hands of tax authorities and the degrees to which they are sharing this with one another are growing, giving authorities greater capabilities for collecting additional tax dollars.” Overall, this is a climate, says Fultz, “where companies can expect growth in the number and scale of audits as well as instances of double taxation to rise, exponentially.”

Double taxation: a worsening issue

As mentioned, 40% of respondents indicate their companies were experiencing double taxation. As for estimates of the associated costs, the most frequently-cited figure is from US\$1-9 million (16%) although 14% cite from US\$10 million and higher.

Double taxation: an already significant issue

Estimated amount of double taxation reported by respondents



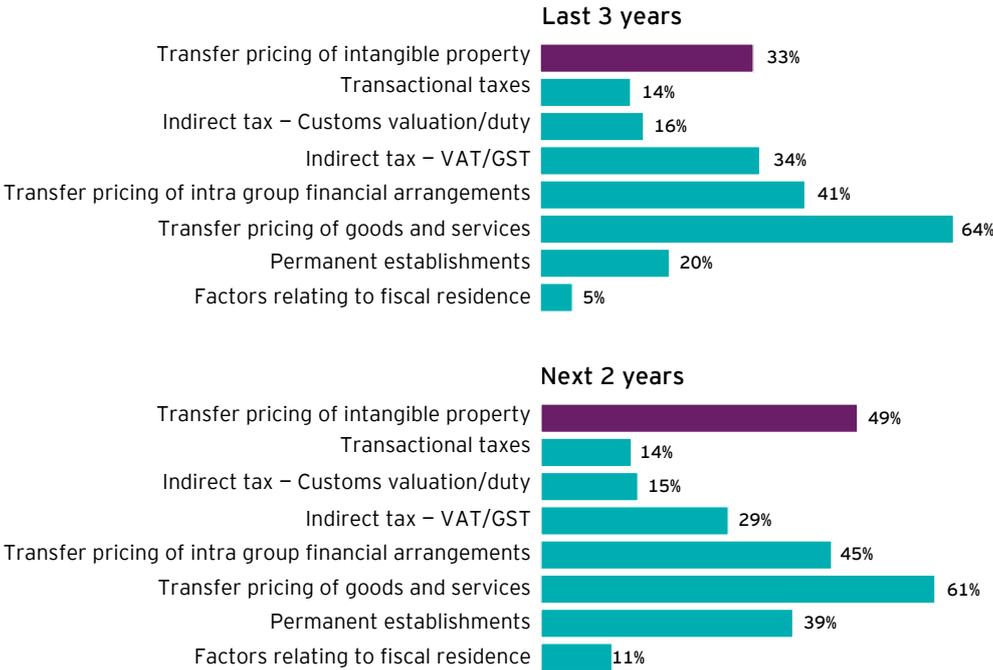
Two key pressure points: intellectual property and permanent establishment

The survey provides significant insights into not only the drivers of past transfer pricing challenges, but also into areas where companies say they anticipate encountering more controversy going forward.

By far, the areas previously deemed most critical in terms of tax controversy include the transfer pricing of goods (64%), intragroup financial services (41%) and value-added tax (VAT) or good and services tax (GST) (34%). Other less-frequently cited, but still important, areas include transfer pricing for intellectual property (IP) (33%), issues relating to permanent establishment (PE) (20%), customs duty and indirect taxation (16%), transactional taxes (14%), and issues relating to fiscal residence (5%).

Going forward, survey respondents expect little to no change across most focuses with two highly notable exceptions: IP and PE. Expectations for challenges to IP rise to 49% (up from 33%), to become the second most important issue within tax controversy (up from fourth). Meanwhile, the frequency of mention for expected PE controversy nearly doubles from 20% to 39%.

Intangible property growing as an important area of tax controversy



All of this is to be expected, says de Ruiter, “because both the initial BEPS project and the new OECD project now will introduce changes to how tax authorities are able to re-evaluate IP charges and the establishment of PE.” Even so, de Ruiter believes the frequency and scope of controversy in these areas will be even greater. “A great many of the changes we are seeing in the various tax reforms are more closely targeting IP in particular.” In general, says de Ruiter, “as the BEPS measures become more widely implemented and other tax reforms come online, tax controversy will rise dramatically.”

Zeroing in

The reasons tax authorities are zeroing in on IP and PE are well understood. A growing share of the worldwide profits of companies are generated by IP, and digital businesses are, in particular, IP-reliant. Global business models have been trending toward virtual or digital for several decades. As they do, more and more businesses are able to sell their goods and services in more places albeit with far less of a physical footprint. In other words, ever-higher percentages of global cross-border cash flows are digital in nature, requiring less physical presence. Location matters in both IP and PE, hence the increased interest by tax authorities.



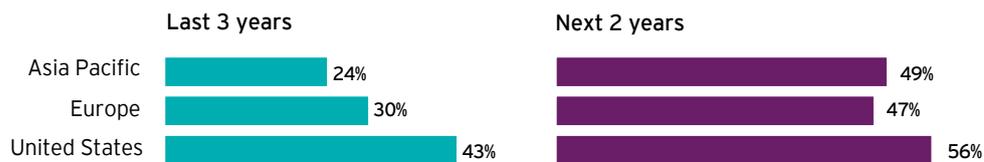
A look at intellectual property

Consequently, says EY Global International and Transaction Tax Services Leader Jeff Michalak, “jurisdictions are seeing businesses generate massive cash flows, but leaving behind a diminishing share of profit in the various countries of operation. Initiatives such as BEPS and the various steps

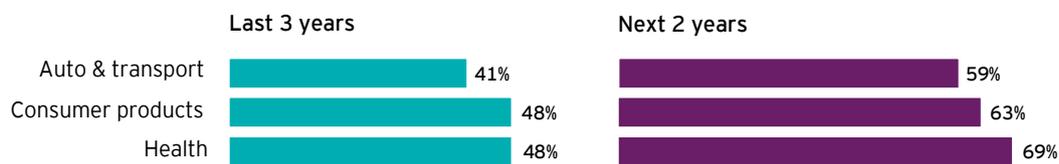
toward tax reform are all aimed at redefining how profits will be distributed in the digital, IP-driven age.” In short, says Michalak, “jurisdictions are trying to increase or protect their shares.”

Intangible property growing as an important area of tax controversy – by geography and industry

Responses by geography



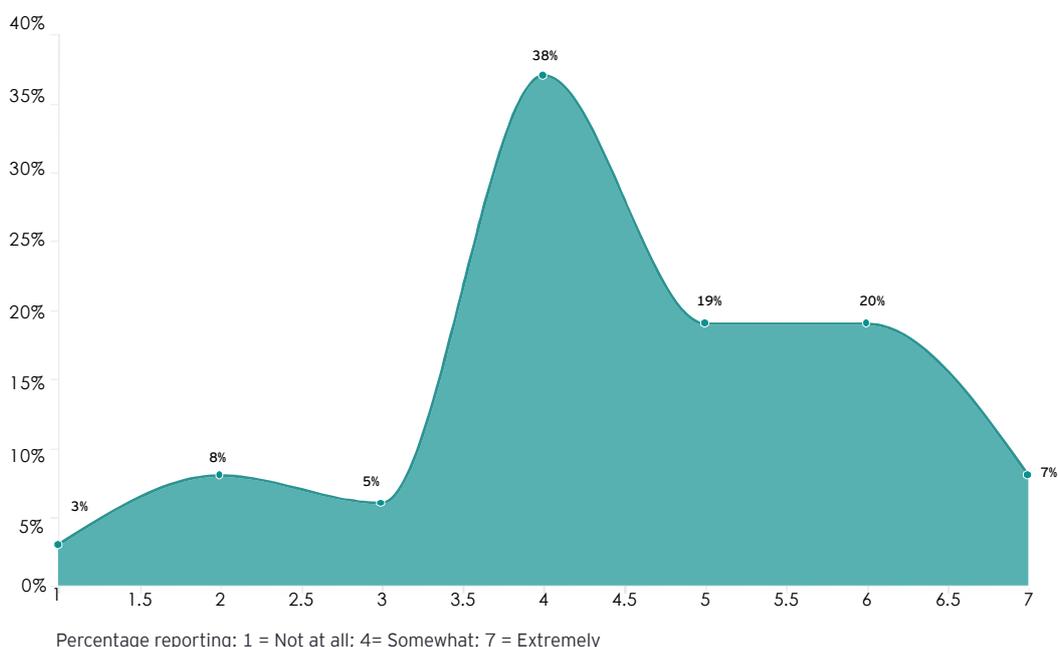
Responses by industry



Some 84% of respondents say that their tax departments are becoming proactively involved in responding to evolving tax rules surrounding IP. At the same time, however, only 29% of executives say their businesses are working to identify or develop value-creating IP. Regarding the latter, says Michalak, “with its value on the rise, more companies and more tax directors should be getting involved, helping their companies do more in terms of developing and managing the location and value of their IP.”

Most tax departments are getting more involved with IP

Tax group involvement with IP reported by respondents



A look at permanent establishment

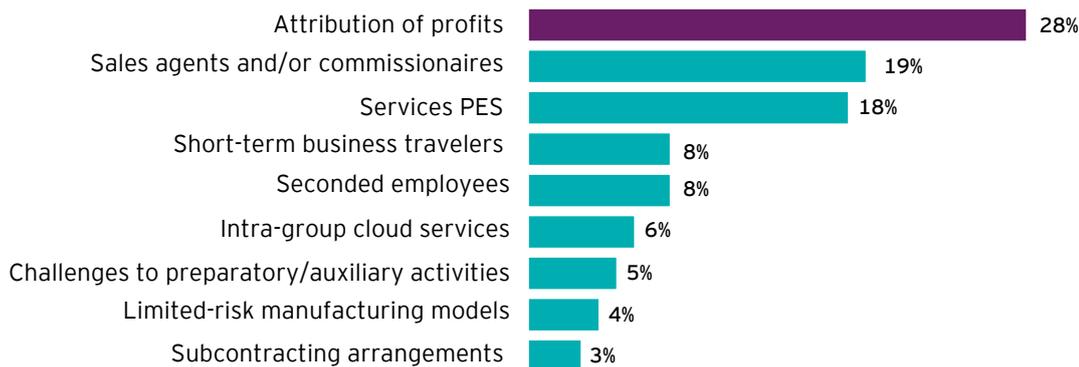
The more digital the business model, the more efforts are needed by tax jurisdictions before they can claim income – which helps explain efforts to more broadly and rigorously define PE.

One in five executives say that within the past three years, their companies have experienced disputes surrounding PE. This breaks down as 11% saying the dispute focused on allocation of profits to their PE, while 9% say the issue was the assertion of the PE itself.

In 41% of such disputes, the national tax authority made an adjustment, although the figure may be significantly higher as 26% indicate they are unsure about the outcome. Similarly, 18% say the authority in question applied a penalty in the case of this assertion, though again the figure may be higher as 33% are unsure about the outcome.

In terms of establishing a PE, the two most frequently-cited bases are sales through agents or commissionaires (51%) and the provision of services (47%). Other rationales include business travelers or seconded employees (18%), construction or assembly of installation projects (9%), arrangements involving subcontractors (7%), toll or contract manufacturing (4%) and “other” (13%).

Attribution of profits predicted to be the most important area of permanent establishment controversy through 2021



Responding to controversy

Companies have options. “Their best option amid rising controversy,” says Fultz “is to be proactive with transfer pricing, to make certain they have a clear understanding of where and how value is created in their companies. To take a strategic approach, using the process to not only document how transfer pricing is done, but also to re-evaluate how their internal processes can help monitor and govern the sustainability of their operating model , helping to optimize operations and to secure the transfer pricing policy ”

In this way, says Fultz, companies can proactively reduce audit and controversy risk. But in addition to fundamentally stronger preparedness, companies also need to consider not only proactive opportunities (such as an Advance Pricing Agreement (APA)), but also reactive tools (such as mutual agreement procedure (MAP), competent authority and even litigation).

The rise of the APA

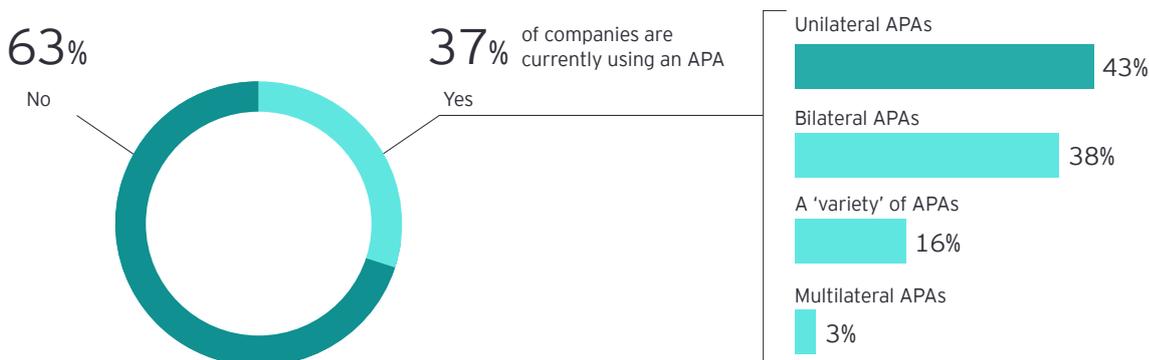
The survey shows that only 37% of companies are currently using any form of APA. But owing to a wide range of global tax and transfer pricing trends, “the factors feeding any decision tree are shifting in favor of ‘yes, we need certainty, and can we achieve that certainty through an APA?’ ” says Fultz. Indeed, the survey agrees with this sentiment, as going forward, 43% say they are either much more likely (4%), more likely (15%) or somewhat more likely (24%) to pursue some form of APA than they were previously (three years ago).

Expanded reliance on APAs as a means of reducing tax uncertainty and risk is not only evident in the survey, but also in reports published by the US Internal Revenue Service (IRS)¹ According to an IRS report, taxpayers filed 203 APA requests in 2018, doubling from only 101 in 2017. By year-end 2018, 458 APA requests were pending, up from

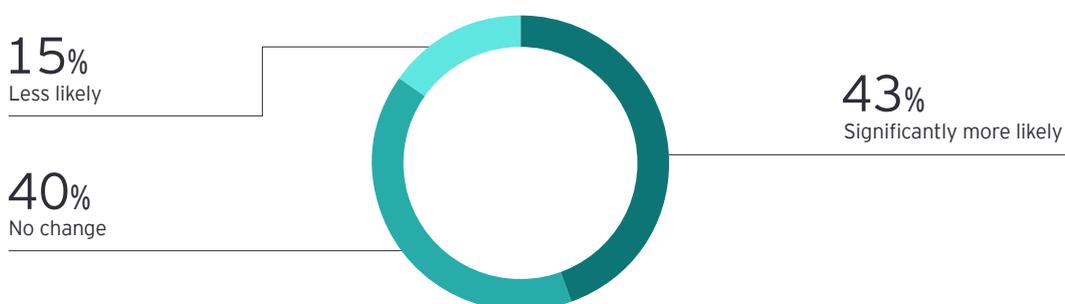
386 and 398 pending requests at the end of 2017 and 2016, respectively. Demand is noticeably strong in terms of bilateral APA filings between the US and India, reflecting what appears to be significant improvement in cooperation between the two nations’ taxing authorities.

All of this makes complete sense to de Ruiter. “I believe what we are seeing is the recognition that given so many evolving, differing interpretations, and legislation and risk, it makes sense to use APAs to gain greater certainty.” Bear also in mind, says de Ruiter, “that with the levels of disclosure being mandated as BEPS gets implemented, companies really aren’t sharing all that much more information than they would have been required to in the first place.” So, in the end, “for a growing number of cases, the added certainty is well worth any added marginal efforts needed to secure an APA.”

More than one-third of respondents use APAs used for controversy management



The numbers likely to pursue APAs are growing



¹ Announcement and Report Concerning Advance Pricing Agreements,” IRS website, <https://www.irs.gov/pub/irs-drop/a-19-03.pdf>

Adds Fultz, “the equation swings even more in favor of the APA when you begin to think about some of the added advantages of an APA.” She adds that one benefit to consider “is that when you’re working on an APA, you elevate the discussion, because you’ll be working with resources from the taxing authorities who have more cross-border experience as opposed to merely domestic experience. You’ll be working with people who have a stronger appreciation for the issues and in some cases, not all, lack of understanding is the key hurdle to resolution.”

In addition, continues Fultz, “once you’ve completed an APA, there’s a halo effect that attaches to your operations around the world.” As Fultz explains, “when tax authorities realize you were able to successfully conclude an APA, it sends the message that you are a cooperative taxpayer and that you’re willing to explain your transfer pricing policy and follow through to demonstrate the fairness and validity of your thinking.”

Finally, adds de Ruitter, “there’s also the benefit of being able to reduce provisions for tax contingencies.” As de Ruitter explains “in one instance, we heard from one multi-national enterprise that their use of APAs was enabling them to reduce provisions by significant amounts.”

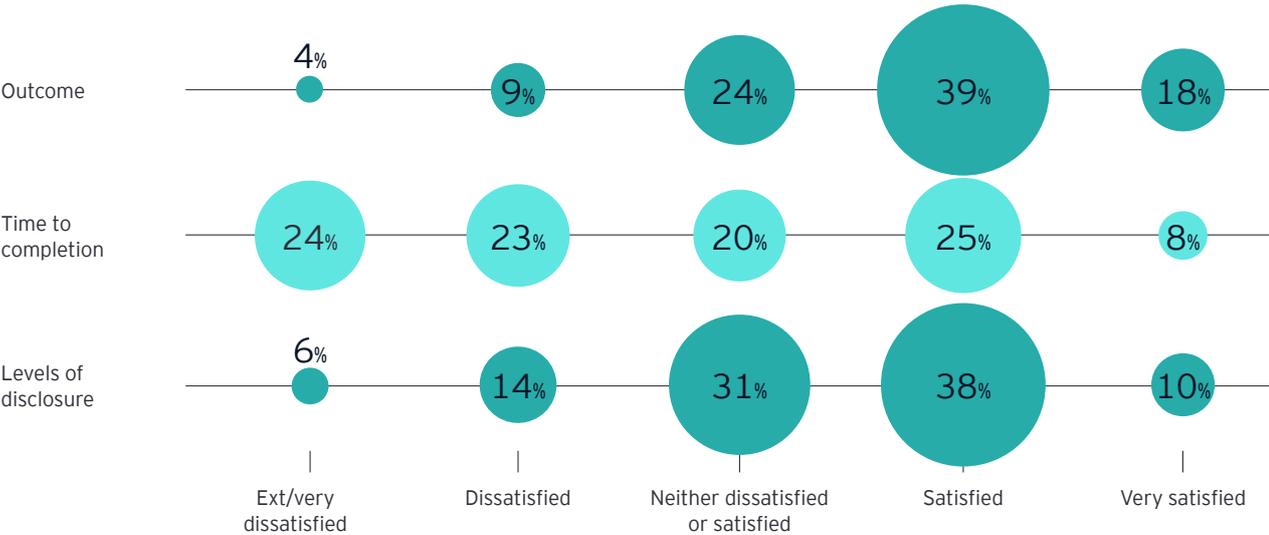
Objections to the APA process

With only limited variation by geography, the survey shows that companies that have completed at least one APA are reasonably satisfied with their results. Specifically, 57% say they are either very satisfied (18%) or satisfied (39%), with about a quarter (24%) feeling neutral on the issue and only 13% feeling dissatisfied. The degree of satisfaction hovers at around comparable levels in terms of the required levels of disclosure.

Where businesses seem to be the least satisfied with the process is with the time required to complete an APA. Here only a third express satisfaction – 8% very satisfied and 25% satisfied. “Indeed,” says de Ruitter, “the elapsed interval for completion can be significant.” In fact, the earlier cited IRS report points out that median time to completion has increased from 33.8 months in 2017 to 40.2 months in 2018.

“But what executives need to think about is what they’re getting for these efforts overall,” says de Ruitter. An average transfer pricing controversy case can take several years to resolve, while an APA on average takes three years. From there, a typical APA achieves five years of certainty looking ahead as well as two or three years back validation. In light of rising tax risk plus all of the additional benefits cited, it is no surprise, says de Ruitter, “that we’re seeing significantly increased interest in APAs – multilateral in particular.”

Companies are reasonably satisfied with their outcome, but concerns over time to completion remain



MAP and litigation

Businesses also need to consider other methods for dispute resolution. Key avenues examined by the survey include the MAP and litigation.

Only one in five companies have requested competent authority assistance, with the remaining 80% indicating “no” (62%) or not applicable (18%). This is just over half the number of companies that have had experience with the APA process, and figures vary little by respondent geography or industry.

Relative to the APA process, executives are significantly less satisfied with the MAP process, in which tax authorities themselves seek to resolve disputes on behalf of taxpayers where multiple governments seek to tax the same transaction or business activity. In fact, only 15% rate their confidence in the effectiveness of the process as either high (14%) or very high (1%) – with even lower scores for efficiency (including required resources and time to completion). Note that this is in spite of clauses under BEPS Action 14 introducing minimum standards to which host nations are expected to adhere. Highlighted in the 2016 report, these contain issues, such as time to resolution and quality of interaction, with everything subject to periodic peer review.

Low confidence in MAP processes often leads companies to forego their right to pursue relief. In fact, 20% of respondents say they are experiencing double taxation, which is expressly addressed by applicable tax treaties, but have decided not to pursue a MAP action. As for why not, 47% said they expected the process to be too lengthy, 37% too expensive and 26% indicate the practical impact was too limited to offset the potential double taxation.

Another stated reason respondents did not pursue such relief stems from written or spoken statements by tax authorities that audit settlements would be void should the company pursue MAP (22%). Another 16% of executives believed that the pursuit of MAP would lead to higher future probability of audits, adjustments and penalties.

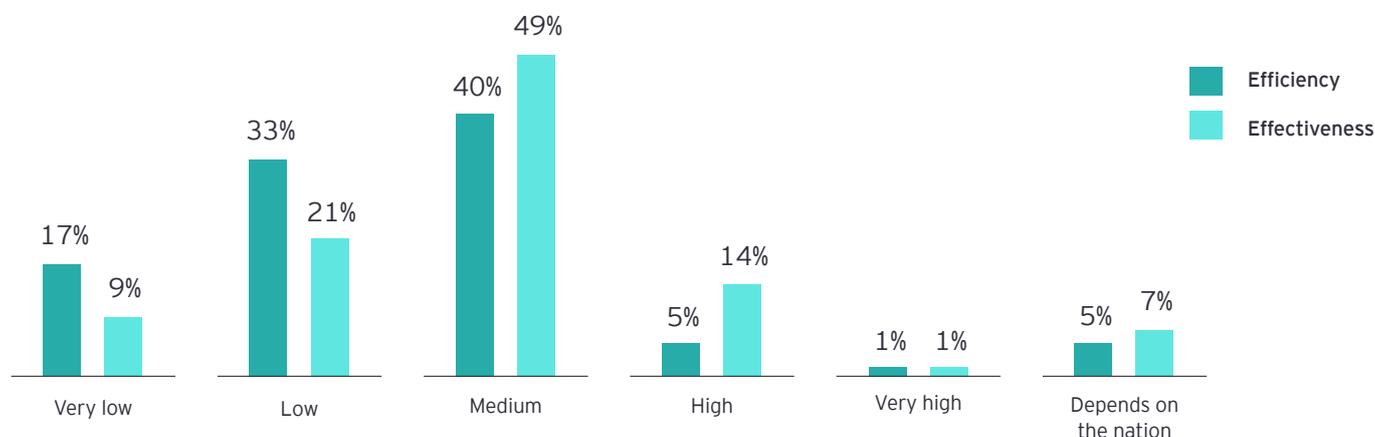
The overall implication is that much more needs to occur before executives place significant confidence in MAP processes. For example, 78% say the inclusion of mandatory binding arbitration in bilateral tax treaties would increase their confidence either moderately (60%) or significantly (18%).

Litigation

Relative to MAP proceedings, executives seem slightly more satisfied with their litigation experience. Just over one in five companies (21%) have referred a domestic matter or matters to litigation over the past three years. Of these, 25% were satisfied with the outcome – of which 4% were extremely to very satisfied and 21% merely satisfied. In contrast, 42% were dissatisfied with their litigation outcomes – of which 9% were very to extremely dissatisfied. A third of companies (33%) were neither satisfied nor dissatisfied.

Overall, says de Ruiter, “as litigation goes, this is somewhat of an expected outcome as judges often take steps that result in neither party being entirely happy with their decision,” a benchmark that confers a sense of fairness to the proceedings.

Relative to APAs, executives are significantly less satisfied with the MAP process



An emerging opportunity: the OECD's compliance assurance program

A relative newcomer to the controversy avoidance and mitigation scene is the OECD's International Compliance Assurance Programme (ICAP). Through its inaugural pilot in March 2018, the OECD invited those willing to be front-runners to explain the numbers in their country-by-country (CbC) reporting to a group of eight participating nations. At the end of a prescribed process, a successful company "obtains a low-risk rating" explains de Ruiter. While by no means legally binding, such as an APA, "a favorable rating does offer a level of assurance to tax authorities that this company is open about and confident in its transfer pricing, and that should reduce tax risk."

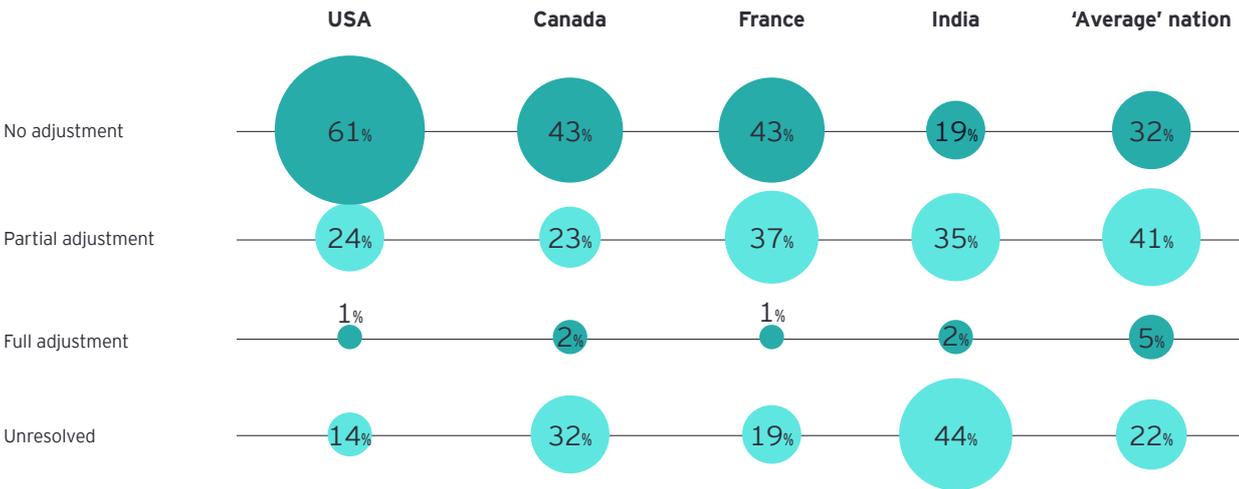
The OECD is currently moving forward with a second ICAP pilot, this time featuring the participation of 17 nations – and according to de Ruiter, the program is attracting significant interest: "For the first pilot, we had no serious inquiries. But for the second pilot, we had six or seven expressing interest." Without question, says de Ruiter, "companies are looking for more ways to reduce their controversy risks."

Controversy experience – nation by nation

In the end, jurisdictions whose actions have led companies to experiencing double taxation by order of frequency include:

- ▶ Germany – 44%
- ▶ Italy – 26%
- ▶ France – 21%
- ▶ India – 15%
- ▶ US – 13%
- ▶ Canada – 6%

Nearly one-third of respondents overall reported no adjustment from recent material transfer pricing challenges





How a global tax reform “revolution” will affect transfer pricing

This final installment of the *2019 Transfer Pricing and International Tax Survey* zeroes in on the challenges presented by global tax reform, including not only the US TCJA but also initiatives such as BEPS and subsequent OECD activity.

“

In the past, the way most international tax teams approached their reporting was to release the least amount of information possible, only that information that could support their case. Today, thanks to BEPS, the current OECD project and a climate of global tax reform, the paradigm has shifted. Now it's the tax authorities who have vastly greater control of the dialogue, companies must adjust.



Jeff Michalak
EY Global International Tax and
Transaction Services Leader

Sweeping tax reform is now a worldwide phenomenon – profound changes are taking place not only in tax rates, but at even more fundamental levels impacting definitions of what can be taxed jurisdiction by jurisdiction.

Overall, says Michalak, “host nations will be extending their claims on income for tax purposes in ways that will guarantee more controversy and double taxation.” The pace and degree of change, he says, “makes it vital that businesses take a comprehensive look at the whole of their tax and transfer pricing strategies.”

Paradigm shifts

The net impact of these ongoing fundamental tax reforms results in nothing less than a handful of what Michalak calls “novel concepts” resulting in “paradigm shifts.” Some of the most significant areas include:

- ▶ **Transparency:** The most profound set of changes, says Michalak, are measures driving dramatically greater tax transparency. In general, “what BEPS has done is introduce vastly greater disclosure, meaning tax authorities now have far more data than ever before.”

This is significant, he continues, “because in the past, the way most international tax teams approached their reporting on an audit was to try and direct the conversation by releasing the least amount of information possible – only that information that could support their case.”

But in the age of BEPS, says Michalak, “now it's the tax authorities who have vastly greater control of the dialogue. They have country-by-country reports, including not only your information but also information from dozens of companies in the industry in which you operate.” Plus, he explains, “they're sharing a great deal more information with other tax administrations where the company in question conducts its business.”

- ▶ **Income allocation:** Nations are also passing legislation broadening their ability to claim broader swaths of income for taxation within their jurisdictions. “Nations are saying that owing to the digital economy, it's now too easy to do business in ‘my’ country without a physical presence.” So, in response, says Michalak, “countries are changing the rules.”

For example, in 2016, the UK introduced its Diverted Profits Tax (DPT) and Australia, its Multinational Anti-Avoidance Law (MAAL). At their core, these are a means to expand jurisdiction with respect to transfer pricing

with related parties in other nations. Companies faced with DPT or MAAL audits, says Michalak, “may see these countries impute profits for domestic taxation – which could be across multiple tax years.”

- ▶ **New focus on intangibles:** Countries in general are renewing their focus on intangibles and, in particular, seeking ways to increase their share of taxable income by reducing the ability to deduct royalties. A good example is the FDI tax, a component of the US TCJA reform. FDI incentivizes companies to maintain intellectual property (IP) in the US by offering an incentive rate of only 13.125% on intangibles-based income earned overseas.
- ▶ **Global minimum tax:** Yet another novel concept, again a key feature within the TCJA, is the introduction of an intangibles-focused global minimum tax. Known as Global Intangible Low Tax Income (GILTI), its purpose is to discourage companies from placing their IP in non-US, low tax jurisdictions, thus generating significant streams of low tax income. GILTI is also seen as a means of encouraging US-based and other companies to develop and maintain their IP in the US.

Closely related is the Base Erosion and Anti-abuse Tax (BEAT). BEAT targets both non-US and US companies whose revenue stems from services. That is, companies whose activities are deemed to drive reasonable profit from the US by use of interest, rents or services fees may be subject to BEAT.

Other nations may soon implement similar minimum tax provisions for intangibles. Meanwhile, the UK has already enacted something similar of its own. Known as Offshore Receipts in Respect of Intangible Property (ORIP), “this allows Her Majesty’s Revenue and Customs (HMRC) to tax a greater share of intangible income, such as royalties, where the sales take place in the UK,” says Michalak.

- ▶ **The end of arm’s length?** In a final example of the paradigm shift, “tax authorities, in general, are moving away from the time-honored arm’s length standard,” says Michalak. “This has been the ‘old economy’ standard for many decades,” say Michalak. But today, “within BEPS the cracks were forming – arm’s length had survived, but its role was downgraded and there was the introduction of additional methodologies.” With the current OECD project, says Michalak, “what we’re seeing is that the OECD and others are looking for completely new ways of determining what fair means in transfer pricing.” Consequently, says Michalak, “reliance on the arm’s length standard may be ending and during the transition to whatever comes next, all the new formulas that will arise, there are likely to be a lot more disagreements and challenges.”

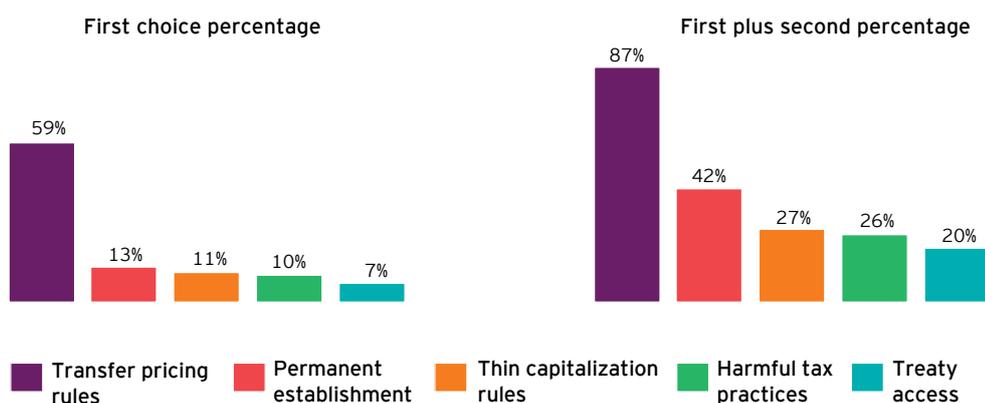
Where executives are focusing

Much of the above-noted change is only coming into focus now. Still, the survey sheds light on where executives are noticing significant change to-date.

- ▶ **Fundamental transfer pricing:** Overall, respondents say the greatest impacts of global tax reform will be felt in fundamental transfer pricing rules. Asked to rank the top three greatest impacts, this was the top (59%) or second (28%) choice among 87% of executives overall – albeit 94% for Asia-Pacific (64% first and 30% second).

The definition of PE was a first choice for 13% overall, or a first or second choice for 42% overall. Finally, thin capitalization rules and harmful tax practices or loss of local incentives were a first-plus-second choice at 27% and 26%, respectively.

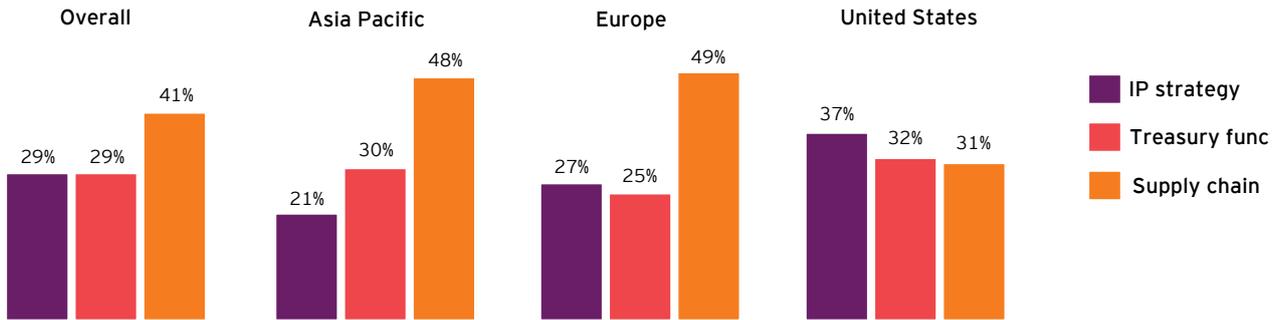
Global tax reforms having major impact on transfer pricing policies



► **Impact on supply chain, IP and treasury:** The most frequently-cited business component impacted by global tax reform is supply chain (41%). Treasury operations and IP strategy tie for second place, both at 29%.

Note, however, there is significant variance by geography. For US companies, IP is the area of greatest impact (37%) with treasury and supply chain close behind (at 32% and 31%, respectively). In contrast, only one in five from Asia-Pacific (21%) rank IP as their top concern.

Overall, supply chains are most impacted by global tax reform; in the United States it is IP



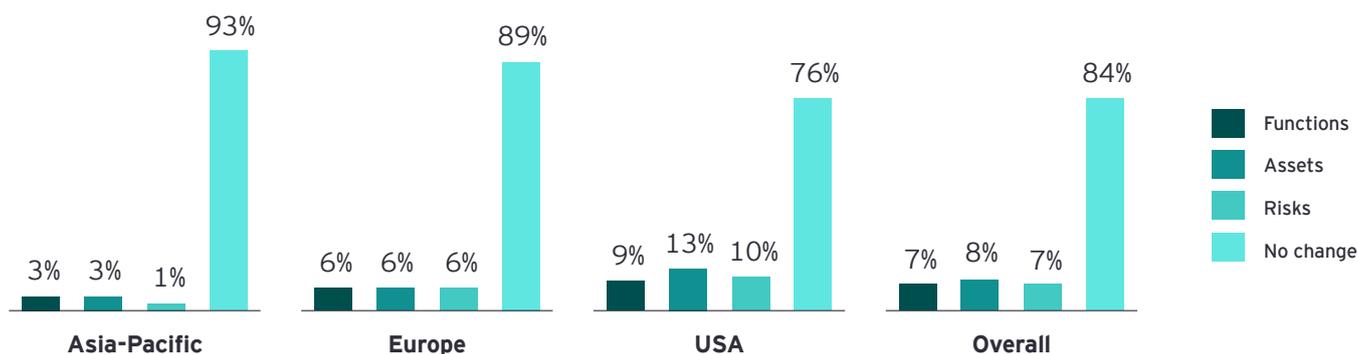
► **Impact of the US TCJA:** Aside from global tax reform, the survey took a deeper dive into the impacts of the TCJA. Here the statistics indicate, at least so far, that even among US companies, the TCJA is doing relatively little in terms of influencing executives to reallocate assets or functional locations. For example, most expectations for changes to functions, assets or risk management as a result of US rate reductions register only single digits. Vast majorities, in other words, plan no changes.

Finally, few companies, regardless of geography, are reporting significant changes in their activities as a result of the US FDI regulations.

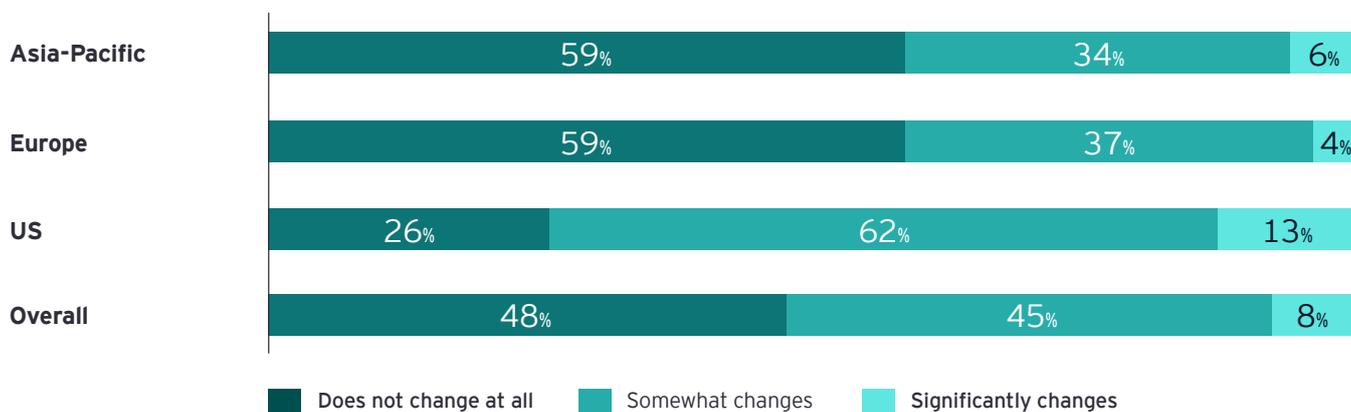
And while overall, only 16% say the TCJA is significantly impacting their tax planning and strategies, the figure climbs to 35% for US companies.



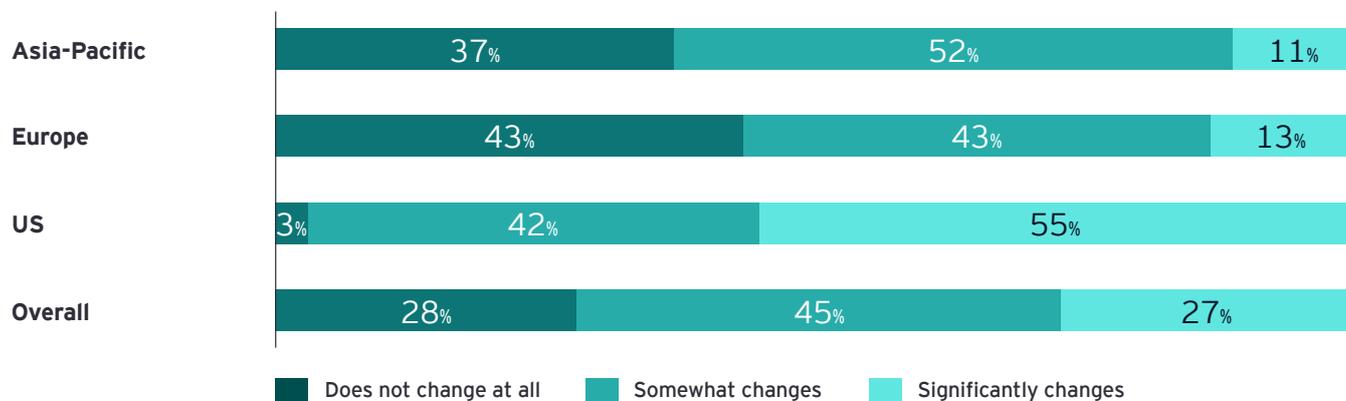
The TCJA is having little impact on existing location decisions ...



... The TCJA's FDII tax is doing little to change global behaviors



But – the TCJA is affecting US corporate tax planning



Forging a response

What it all means, says Michalak, “is that companies need to take inventory of all that’s happening and then do a fundamental reassessment of their transfer pricing strategies.”

In particular, he suggests, “businesses need to put a lot of thinking into how they create value and why the business is structured the way it is, then create transfer pricing documentation to support those hows and whys. You’ve got to be very clear, careful and strategic in this exercise, and then make certain your reporting and documentation is globally consistent.”



You have to be very certain and clear about your story — it must be defensible in light of all the new rules and trends taking place.

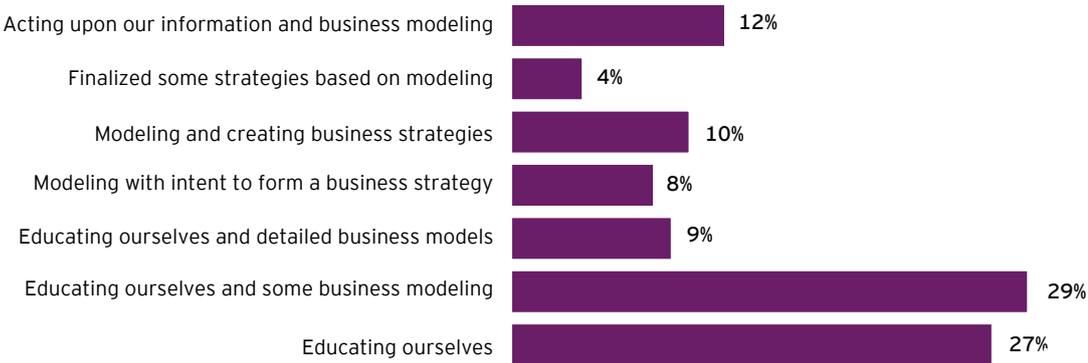


Jeff Michalak
EY Global International Tax and Transaction
Services Leader

Moreover, says Michalak, “you’ve got to begin erring on the side of sharing more, not less, about your transfer pricing.”

Unfortunately, the survey shows that only a minority of companies are taking significant steps in addressing so much global change. For example, only 12% have combed through all of the changes and conducted sufficient modeling to the point where they are able to begin making decisions and business changes. At the other end of the spectrum, 38% are still in the education phase (29%) or have just completed a review and are now just beginning to build models (9%).

Only a minority are acting upon up-to-date insight and business modeling in response to global tax reforms



Beyond adopting a more strategic and comprehensive approach to the whole of transfer pricing, Michalak insists companies must have their documentation ready for presentation to tax authorities at a moment's notice. “The more comprehensive the disclosure, the more thorough and consistent the discussion; and the faster this information is presented in response to an audit or query, the better are your chances the authorities will accept your side of the story. Thorough documentation is your best, if not your one and only, opportunity to lead the narrative.”

In addition to keeping one's own transfer pricing house in order, Michalak recommends that more businesses get more involved in influencing national tax policies. “In the past, it's really been only the largest companies who get involved in discussions and lobbying.” But the degree and pace of change today “is so sweeping, that it becomes really critical that even mid-sized taxpayers should be keeping up and voicing their thoughts and influencing outcomes. Find out what is important to you and then educate officials so that when the rules are written, you're not impacted unfairly.” Overall, Michalak says “companies of all sizes need to get more involved because this is no evolution, this is revolution.”



Key contacts

For a conversation about transfer pricing environment, please contact us:



Peter Griffin
EY Global Transfer Pricing Leader
peter.griffin@ey.com



Jeffrey Michalak
EY Global International Tax and Transaction
Services Leader
jeffrey.michalak@ey.com



Rob Hanson
EY Global Tax Controversy Leader
rob.hanson@ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. For more information about our organization, please visit ey.com.

© 2019 EYGM Limited.
All Rights Reserved.

EYG no. 004785-19Gbl
1909-3266888
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.

ey.com