METROPOLITAN
CORPORATE COUNSEL®

JULY / AUGUST 2016

WWW.METROCORPCOUNSEL.COM

MCC INTERVIEW: Henric Adey / EisnerAmper

Avoiding International Taxation Pitfalls

Transfer pricing has emerged as a key component of overall business strategy. Is it part of yours?

*The long established prior understanding of transfer pricing is in the midst of a global revolution. As discussed below, transfer pricing is no longer just a tax compliance matter for larger multinationals but has far-reaching implications for any cross-border transactions between related parties. As businesses globalize, governments seek to tap into more revenue sources, and with regulatory change in full swing, transfer pricing is being reevaluated. Transfer pricing and international tax expert **Henric Adey** explains the rapidly evolving global business tax environment. His remarks have been edited for length and style.*

MCC: Tell us about your background as it relates to international and multistate transfer pricing.

Adey: My background is international by nature. I was born in Germany, raised in the UK, and then came to the United States, where after completing my Ph.D. in economics, I went into the world of transfer pricing, beginning at a Big 4 accounting firm.

MCC: Please give our readers a brief overview of the transfer pricing landscape and the international tax and transfer pricing challenges faced by global companies.

Adey: The transfer pricing landscape has changed significantly within the last couple of years. With transfer pricing in the press, especially in Europe, and with talk about a fair tax regime and efforts to avoid a race to the bottom with respect to minimizing effective tax rates, transfer pricing has come to the attention of the broader population and not just tax experts. That incudes what we see now with the Organisation for Economic Co-operation and Development (OECD) project dealing with base erosion and profit shifting (BEPS).

Henric Adey
The Transfer Pricing Practice Leader at EisnerAmper LLP.
henric.adey@eisneramper.com

If your intercompany tax policies aren't quite aligned with your business realities, it is time to revisit and get it right.

Especially with many countries needing to assess a realistic tax revenue basis to pay for their public services, transfer pricing is at the forefront. With heightened scrutiny on an audit level, it is very important that companies think about and document their policies for both planning and compliance purposes. If your policies aren't quite aligned, it is time to revisit the overall transfer pricing strategy and align it with your business reality.

MCC: The complexity of transfer pricing requirements is challenging, and regulatory scrutiny of transfer pricing practices seems to be on the rise. Why is that? Is there more wrongdoing, heightened scrutiny or both?

Adey: The complexity of the requirements and the regulatory scrutiny are both on the rise. Countries seeking to maximize their own tax revenues and make sure that they get their fair share are revisiting their regulations to see if there are any loopholes that allow outflows of tax revenue from a jurisdiction. Historically, the U.S. was (and arguably still is) at the forefront of establishing transfer pricing regulations, addressing profit shifting through the pricing of intercompany transactions, and the OECD guidelines followed suit with many countries adopting the OECD guidelines into their local regulatory tax framework. The recent OECD BEPS initiative highlights that it is paramount to reevaluate a company's value drivers and have contemporaneous documentation in place.

MCC: When you are engaged to analyze a company's transfer pricing strategies and practices, what are you looking for? What are the red flags that tell you there may be problems?

Adey: That is an important question. When you first talk about transfer pricing, you hear a lot of companies say it's a compliance exercise, and they'll just update the last study, put it in a drawer and wait for tax authorities to knock on their door. That's not the right approach. It's better to ask about long-term strategy, the outlook for the business, what was the ex ante intent of the original transfer pricing policy and what jurisdictional footprint is important for their operations. Then we can look at the current policy and see if it aligns with the company's transfer pricing strategies, documents, policies and practices. A lot of times you find it does not. Once you align the policy, business outlook and strategy for the company as a whole, you can put the appropriate compliance pieces in place. Overall, it is a strategic outlook and not necessarily simply a compliance exercise.

MCC: Transfer pricing schemes also raise opportunities for companies. How can companies take advantage of tax savings and other opportunities inherent in transfer pricing?

Adey: The key is, once again, to take a holistic strategic outlook of a company over a longer horizon. There are many items that need to be examined in detail. For example, Hong Kong made a recent announcement inviting multinational companies with significant IP portfolios into their jurisdiction to consider Hong Kong as a potential IP hub. There is a lot of due diligence to be done to consider tax restructuring in the current regulatory environment. A thorough cost-benefit analysis and a careful IP valuation exercise have to be conducted before moving forward on something such as that.

MCC: What's the most important thing for a new company facing its first exposure to transfer pricing to know? How do you advise new companies?

Adey: The first time that you set up an affiliated entity in another country you should have transfer pricing on your mind. It is always better if you can document an ex ante approach than ex post factual representations. Furthermore, if you are an inbound multinational into the U.S., it is not just an international issue so don't ignore state tax considerations. Important questions should be addressed. What is the strategic plan regarding opening up an affiliate in a foreign country? What is the long-run plan? What's the characterization of the entity you are setting up abroad? Is our original intent fulfilled? Are the functions the same as we had in place originally? Has asset ownership shifted and risks altered?

In addition to putting a policy into place and having everything documented appropriately, make sure that you have also considered important people functions. As you go forward and you grow that entity, you need to always reevaluate whether the facts are aligned with your policies. If you think about transfer pricing from day one (i.e., take an ex ante approach), you definitely have a head start, and you are much better off when planning in the future.

MCC: What traps are most likely to trip up unwary companies with transfer pricing issues?

Adey: Generally, traps can be in the form of not implementing your transfer pricing policy, not reevaluating the value chain on a contemporaneous basis and making adjustments post-year end that are not really aligned with the original intent of your transfer policy. Another common trap is that there are intercompany agreements being put in place that do not reflect the reality of the business. These contracts are purely legal in nature and do not reflect a company's tax and business reality, which do nothing to support the actual transfer pricing position. It is very important to reevaluate those documents and make sure that these agreements truly align with the business realities. Also, be sure that the language in there is being contemporaneously reviewed on an annual basis.

MCC: As global supply chains stretch further and further and grow more and more complex, what are the key transfer pricing issues?

Adey: The key issue is that governments are more often cooperating with one another and increasing the exchange of information to better understand how a global supply chain works, identifying the value drivers, important people functions, IP ownership and risks for a company. It is really important that a company is aware that this requirement for transparency is going to increase. In the past, companies sometimes were able to evaluate transfer pricing on a country-by-country basis, where the information was specifically developed for local regulatory requirements. Now, with more information being exchanged, there's a real need to trace the functions, risks and assets throughout the global supply chain and make sure that this is properly documented at the parent level but also at the local subsidiary level.

MCC: Is there anything else you would like to share with the readers?

Adey: The next couple of years will be particularly interesting. There is a common misconception that the OECD's release of BEPS only affects large multinationals. That's not necessarily true. I think some of the concepts being discussed in BEPS will not necessarily be formally applied directly to smaller companies, but will definitely be considered in spirit as BEPS is going to drive the thought processes of tax authorities. You may not have to file a country-by-country report, but the world of transfer pricing has changed, and it makes sense for smaller entities – even at the state and local level – to consider transfer pricing and see if there is any potential exposure.