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## **Transfer Pricing Mistakes SMART Companies Make Over and Over Again**

How can you avoid these same blunders?  
Follow our expert advice.



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We know you take transfer pricing compliance seriously. Every year, you prepare robust documentation. You're transparent with tax authorities, and you adhere to local legislation. Good for you. But sometimes even companies with the best intentions trip up—and those glaring missteps could be the difference between a rock-solid tax position and hefty penalties and/or adjustments.

So, what can you do? Sidestep mistakes, of course—and we're here to help. We've rounded up five common transfer pricing blunders that smart multinational companies make time and again (without even realizing it!), and we offer expert advice on how to avoid making these same costly errors yourself. After all, today's tax authorities have so many tools to help them find fault with a multinational company's transfer pricing—why make it any easier for them?

### **Mistake #1:**

**You underestimate today's tax authorities—and think transfer pricing examinations are reserved for other companies.**

Whether you're a big company, a small company, or anywhere in between, tax authorities are looking at your transfer pricing. Today's tax administrations are more sophisticated than ever, instituting transfer pricing risk-assessment systems to detect which taxpayers are most susceptible to transfer pricing adjustments (who has time to waste with those that aren't?). Australia's Practical Compliance Guidelines, for example, show you how to assess your own risk and let you see your company's tax position through the eyes of the Australia Taxation Office (ATO). Sure, it sounds like a favor but there is a flip side: If you're in a high-risk position, the ATO knows you're low-hanging fruit for transfer pricing adjustments. Risk assessment systems are just part of today's tax scrutiny. Tax authorities are educated in transfer pricing, adding routine reviews to their agendas, increasing staff, and creating special teams to flag transfer pricing issues. The ATO launched a Tax Avoidance Taskforce and a Top 1,000 Program, in which it annually reviews the largest 1,000 companies—red flags or not—to make sure they are reporting the right amount of income tax Down Under.

Australia's not alone in its tax-avoidance efforts. Belgium's tax authorities have created a Transfer Pricing Cell (TP cell), an educated group solely dedicated to reviewing the transfer pricing of multinational companies. The audit department is smart and aggressive, sending multinational companies customized questionnaires asking for specific information about intercompany financing, acquisitions, and restructurings. The TP cell has doubled in size over the last five years (we hear more staff is coming), so they have the resources to painstakingly comb through master and local files to detect the slightest



discrepancies. And if auditors detect a red flag at one local entity, it's bad news for every entity in Belgium as they're likely to audit all local entities in the group.

And let's not forget your role in all of this. Thanks to increased transfer pricing regulations, you have no choice but to supply tax authorities with more information than ever, practically spoon-feeding them the ammunition they need to issue transfer pricing adjustments. Not only do they have more documentation and information at their disposal, but they're sharing it with other tax administrations; so if there's a problem in one country, you can bet there'll be questions in another.

## **Avoid the Same Mistake:**

**Prepare documentation with the expectation that tax authorities will read it—and answer their questions before they get a chance to ask.**

When it comes to today's tax authorities, you need to put yourself in the driver's seat. This means being proactive about your risk position, controlling your transfer pricing narrative, and addressing concerns before they become crises. And the effort starts long before you prepare transfer pricing documentation. Know your vulnerabilities, so you can explain them. Do you have transactions that tax authorities love to put under the microscope—say, service transactions, royalty payments, or business restructurings? Tax authorities tend to see these arrangements as a means of profit shifting and countries like Italy, Kenya, the Netherlands, New Zealand—among others—are giving them special attention, which means you'll have to apply some special TLC, as well.

Where else are you on thin ice? Are your routine returns routine? Are you experiencing profit volatility or losses? To tax authorities, these situations are warning signs, so you need to take stock and explain them proactively in your documentation. Take control of your narrative and tell tax authorities how Covid-19 shook your supply chain and how limited-risk entities had to assume more risk than usual. Or discuss how extraordinary circumstances, like international sanctions, for instance, caused the cost of raw materials to skyrocket, launching usually steady cost-plus calculations into the stratosphere. Once you identify your vulnerabilities, you can begin to prepare robust, contemporaneous documentation that adheres to local regulations. A bull-by-the-horns approach to transfer pricing compliance shows tax authorities that you've got nothing to hide and spares them the trouble of asking you the questions that you've so wisely already answered.



## **Mistake #2:**

**You downplay the importance of transfer pricing documentation because you're not required to submit it.**

Let's face it: Some countries don't require you to submit documentation—but most require that you prepare it contemporaneously, which means by the time the tax return is due. While the obligation to prepare documentation may sound optional, it isn't, and you'd be wise to take that demand just as seriously as the one to submit a tax return. Why? Because if tax authorities unexpectedly request transfer pricing documentation (and they often do), then you must submit it—and that usually means fast. Hungary, for example, demands documentation on the spot. Poland wants documentation within 14 days of the tax authorities' request and Belarus within 10 working days. If your documentation isn't already prepared, you won't have enough time to scramble up functional interviews or construct brilliant narratives explaining why losses are always in high-tax jurisdictions. Even for countries that have more generous 30-day deadlines (China, France), it's just not enough time to prepare sufficient transfer pricing documentation from scratch—and without it, you'll be incompliant and subject to steep penalties.

Having documentation prepared and ready to go shows you're taking your transfer pricing compliance obligations seriously, and your good-faith efforts and cooperative spirit are often rewarded with lighter penalties—sometimes, none at all. Don't underestimate that good fortune: In the UK, HMRC has been known to issue penalties of 30% of the additional tax due for careless behavior and 100% in more serious cases. Italy's administrative penalties range from 90% to 180% of the additional tax due—and don't forget, penalties come on top of adjustments, so those numbers really add up. In case you haven't noticed, tax authorities aren't great at keeping secrets—count on word getting around that your information (or lack thereof) is insufficient and expect a string of tax authorities to summon the documentation that you still haven't prepared. And if there is anything suspicious in contemporaneous transfer pricing documentation, the burden of proof usually rests with the tax authorities—they have to prove the taxpayer did something wrong. But if you don't have contemporaneous documentation in place, that burden could shift and you'll have to prove your documentation is right on the money—an uphill battle if you rushed to prepare it.



## Avoid the Same Mistake:

**Prepare contemporaneous documentation as if you'll have to submit it.**

The key to outstanding transfer pricing documentation is adhering to country-specific regulations—all regulations, even the ones that require you to gather information, explain your related-party transactions, and then tuck it away, just in case. So, when transfer pricing legislation mandates that you prepare documentation, make the same heroic efforts in preparation that you do in the reports you're required to submit. After all, you never know. That means model your transfer pricing throughout the year, so you know you're operating with arm's length pricing. Look at your business operations and make sure your functional analyses align with your true value-drivers. Have functions and risks jumped around the supply chain? Document those shifts accordingly. Are your transfer pricing benchmarks still comparable? At the very least, update the financials to calculate a current arm's length range. And, just like the actual information, make sure the format of your reports coincide with a jurisdiction's requirements—the U.S., for instance, prefers 10 principal documents as opposed to the OECD's master and local files.

Once you've got it all together, save your documentation in an accessible place and make sure relevant staff members can access it. If tax authorities request the information—maybe years later after you've changed companies—then the taxpayer is still covered. And don't forget preparing documentation isn't just about the tax authorities—there are huge benefits for you. Preparing robust, contemporaneous documentation is essential for strategic tax planning as it gives you a sense of your tax obligations and benefits around the world. (Wait—those losses aren't where we need them. We can't have so many entities in tax havens.) Plus, transfer pricing compliance is an annual, ongoing exercise, and by preparing documentation this year, you're already ahead of the game next year.

## Mistake #3:

**You fail to maintain books and data at the entity level.**

It may sound crazy, but many companies don't have the data to support—or implement—their own transfer pricing policies. How can you justify arm's length transfer prices without data? Take the cost-plus method, for instance. If your policy is to apply a certain markup on costs, which is common in manufacturing transactions, you have to have documents to substantiate those costs. Without them, how can you (or tax administrations) know what's appropriate? Lack of data is always a red flag for tax authorities—it signals the company has something to hide. Sometimes, the absence of data can lead to a “shotgun audit,” meaning that since there's not enough data to take a stand on one issue, tax authorities



dive in and ask about everything. For taxpayers, it's a legal nightmare. You could have to produce reports about anything (and possibly everything), gather more information throughout the group, scramble to find invoices and emails, track down contracts (or draw up new ones), and be on call to answer questions.

## **Avoid the Same Mistake:**

**Make the tax department of every entity part of the overall business.**

The C-suite of a multinational business may not be too concerned with what's happening at the entity level, but as a transfer pricing executive, you have to know how each entity goes about pricing goods and services—after all, one misstep could have consequences that ripple through the rest of the group. Meet with executives at local subsidiaries and at headquarters and educate them about today's aggressive regulatory environment. Explain to legal and finance departments how entity-level data, like costs or net sales associated with resales, are essential to proving that your intercompany transactions are arm's length. Of course, tax authorities will examine master and local files, but if they have questions, they'll also want to see the documentation that supports them—contracts, invoices, correspondence, and so on.

Micro-level data can help headquarters get a holistic view of the whole group. Companies should centralize systems so that the same data is tracked, reported, and stored at each entity. Analyzing information at the entity level can help strategic tax managers mitigate risk and maximize tax benefits—efforts that circle back to the good of the organization as a whole. That is, if you have the data.

## **Mistake #4:**

**You're not consistent with your documentation across the board.**

It seems like a no-brainer, but inconsistencies are rampant in transfer pricing documentation—and there's a good reason. Often different tax departments from various entities prepare their own parts of the documentation package and nobody is overseeing the package as a whole. A local entity typically prepares the local file and generally, the parent company prepares the master file and the country-by-country report—for a company lacking synergies, it's easy to note X on one document and Y on another. For instance, an entity may report that an intangible asset, say a trademark, is extremely valuable in the local file. But then, the master file doesn't mention the value of the intellectual property at all.



Even worse, taxpayers have been known to contradict themselves in the same document. For example, a taxpayer may characterize an intercompany transaction as, say, a full-fledged distributor—a company that performs important functions and assumes a significant amount of risk—but then the functional analysis shows that the same transaction is that of a limited-risk distributor, a company that performs low-level functions and assumes very little risk. These kinds of glaring errors are easy wins for tax authorities, and you can be sure they'll be citing them to make transfer pricing adjustments.

### **Avoid the Same Mistake:**

Centralize your transfer pricing compliance process.

Aligning your transfer pricing documentation with your tax return, your country-by-country report, and any supporting documentation—intercompany agreements, outside contracts, and of course, your transfer pricing policy—reinforces your tax position and your transfer pricing narrative. Plus, sending a cohesive message throughout the multinational group shows tax authorities that you have nothing to hide.

The master file and local file should be the backbone of what's presented in the country-by-country report. Centralizing a group's transfer pricing documentation—from gathering information to consolidating the documentation preparation—streamlines the compliance process and gives you a coveted holistic view of the group's operations. Of course, that doesn't mean that you won't have to involve local entities or other departments. To ensure arm's length pricing and adhere to country-specific legislation, you'll need data from local finance, legal, and tax departments, so befriend them and make information gathering a team effort.

Transfer pricing compliance starts long before you enter information into the master and local files. Supporting documentation has to evolve with the business. Tax authorities often ask taxpayers for intercompany agreements, so they can see how companies legally interact with one another. Failure to produce them means you can be denied tax deductions on legitimate costs because you don't have a legal leg to stand on. Look at 2020—when most businesses changed how they operated due to the Covid-19 pandemic. But did you update your transfer pricing policy? Do profits align with value creation in the current environment? Are limited-risk entities still limited-risk? Has there been any restructuring? Have functions and risks found new homes in the supply chain?

What about your intercompany agreements? When things are going well, busy tax and legal executives often overlook the importance of updating these critical documents because they only present value if something goes wrong. Signing on the dotted line may



seem like the finish line when it comes to an intercompany agreement, but really, it's just the beginning. You'll need to put a process in place to review and update them, too—so, make someone responsible for maintaining these potentially lifesaving contracts. After all, you went through the trouble of generating them for a reason—to protect your company. But, as your business evolves, if you don't revisit them, they can't offer the protection you created them for in the first place.

### **Mistake #5:** **You don't leverage technology.**

In today's transfer pricing world, there are just too many reports, too much data, and too many obligations. And let's not forget about country-specific requirements, which differ from one country to the next in terms of nitpicky information and formats.

For example, Denmark's master file is consistent with the OECD's recommendation. But India's everything-but-the-kitchen-sink master file is completely different. Along with the OECD's recommended information, India requires information about entities that develop and manage intangible property and in-depth details about the group's financing arrangements (including information about the top 10 unrelated lenders). Meanwhile, the U.S. mandates that you prepare 10 principal documents (same OECD information, different format), and China's master file requires information on business restructuring, how functions, assets, and risks migrate through the group; R&D entities; and information about entities listed in your country-by-country report. If you're a multinational company with intercompany arrangements in numerous jurisdictions—and even if you only have a single cross-border transaction—how can you possibly keep up with every country's every demand?

We haven't even mentioned transfer pricing benchmarking, the foundation of your whole economic analysis. Today, you can't merely rely on strong comparable companies. Many countries request local, or at least regional, benchmarks—or as we like say, needles in haystacks. Traditional comp searches mean hours and hours of pouring over results churned out by databases that weren't even designed for transfer pricing, leaving you in a fingers-crossed tax position at best. Short staffed? You'll never have the time to conduct fresh benchmarking searches that produce indisputable comparables, and if you're thinking traditional outsourcing is the answer, expect a bill for the over-the-top hourly rates that come with it.



## **Avoid the Same Mistake: Embrace transfer pricing software.**

In a world of unique country-specific regulations, impossible-to-find transfer pricing benchmarks, understaffed tax departments, and hawkish tax authorities, you need an ace up your sleeve when it comes to compliance. Enter transfer pricing software, which does all the heavy obligatory lifting for you, freeing you up to tackle the strategic parts of your job. (Remember those?)

Forget straddling Excel worksheets (and the frustration of losing links while you do). Transfer pricing software can calculate accurate, customized arm's length ranges—and so much more. In the last year, Thailand, Denmark, and Mexico, among a string of other countries, updated their transfer pricing legislation, creating additional compliance burdens for taxpayers. Other jurisdictions, including Jordan, Estonia, and United Arab Emirates, launched new transfer pricing legislation altogether. (Spoiler alert: More countries will follow suit.) In fact, there is so much happening on the transfer pricing legal front that you could turn tracking new laws and interpreting new guidance into a full-time position. Or you can enlist transfer pricing software to do the job for you. Transfer pricing technology keeps track of country-specific laws, updates in real-time, and even flags you when you make critical, eyebrow-raising omissions.

Another huge advantage: Software looks at companies through a transfer pricing lens—identifying reliable comparables based on functional comparability, the essence of proving arm's length pricing. Working in a country that prefers local comparables? (Say, Japan, Canada, or Hungary.) Software finds comparables where you need them. And remember the long hours, days, weeks, you used to put into a single comparable company search? Software evaluates companies and delivers a reliable comparable set in roughly a minute. And while a tool offering efficient comp searches, accurate calculations, and country-specific compliance may sound expensive, software costs a fraction of what you'd pay for traditional outsourcing.

Transfer pricing technology helps centralize processes, maintain consistent data, and it flags you when information is missing because you weren't aware of the new transfer pricing laws in Malta, or Estonia, or Poland, or Mexico, or (you see where we're going with this). It guarantees accuracy and saves you time and money. Best of all, it helps you avoid glaring transfer pricing mistakes—which in today's predatory world, you simply can't afford to make.



# CrossBorder Solutions: The World's AI tax expert

CrossBorder Solutions is the global leader in technology-driven tax solutions. The company develops software powered by advanced AI to help taxpayers accurately comply with jurisdiction-specific requirements, and dramatically lowers the fees associated with this type of work. Today, thousands of companies worldwide rely on CrossBorder Solutions for their transfer pricing, R&D tax credit, and tax accounting (tax provision) needs.

CrossBorder Solutions is backed by Insight Partners, the leading private equity firm in the world. We have achieved a billion-dollar valuation and raised over \$100M in growth capital to date. These investments are leveraged to continue to develop and maintain Fiona, our proprietary AI engine, and expand global operations to serve a diverse and growing client base.

For more information on CrossBorder Solutions and its AI-powered tax solutions, visit [www.xbs.ai](http://www.xbs.ai) or call 646.767.7342

