



THE DIGITAL
TRANSFER PRICING
COMPANY

RUNNING NEXT TO THE BICYCLE

CHALLENGES, MITIGATION STRATEGIES AND IDEAL
WORLD OF IN-HOUSE TRANSFER PRICING PROFESSIONALS



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EXECUTIVE SUMMARY

The purpose of this survey study was to understand the daily challenges of in-house transfer pricing professionals, how they mitigate those challenges and what is their ideal transfer pricing world. The survey was carried out in Autumn 2020 through 100+ interviews with in-house professionals from various sized MNEs operating in a number of different industries. The study's main finding was that most of the challenges being faced are related to data and processes and while technology is generally seen as the main remedy, the ways in which MNEs mitigate these challenges tend to be far from technological. The primary reasons for this gap related to time and budget constraints, a general lack of understanding of the technological possibilities and realities as well as an inability to find suitable technology. The report concludes with a number of suggestions as to how to potentially bridge this gap.

1 INTRODUCTION

Transfer Pricing is a primary concern of tax departments in MNEs. One of the most significant current discussions regarding transfer pricing is how technology can be used to mitigate the challenges organizations face as well as offer new value, when their subsidiaries operate in different jurisdictions worldwide.

Even though the discussion around the digitalization of transfer pricing is currently very topical, it has really only taken off in the last few years, which is somewhat surprising given that digitalization has already transformed most other MNE functions. Therefore, we wanted to take an agnostic approach to our study and let in-house professionals themselves describe their challenges and to set-out their ideal transfer pricing world. The goal was to truly understand whether technology is seen as a viable solution to help in overcoming the everyday transfer pricing challenges or alternatively are other types of mitigation strategies already enough.

The survey was carried out through 100+ interviews (70 structured, 30+ free form) during Autumn 2020. The significant number of interviews undertaken was complemented by the fact that the respondents also represented a healthy cross-section of different industries and company sizes with a geographical focus on Europe and the US. Questions that were posed related to the respondents' current transfer pricing process, their main challenges, the ways in which they mitigate those challenges and, finally, their "ideal world" vision.

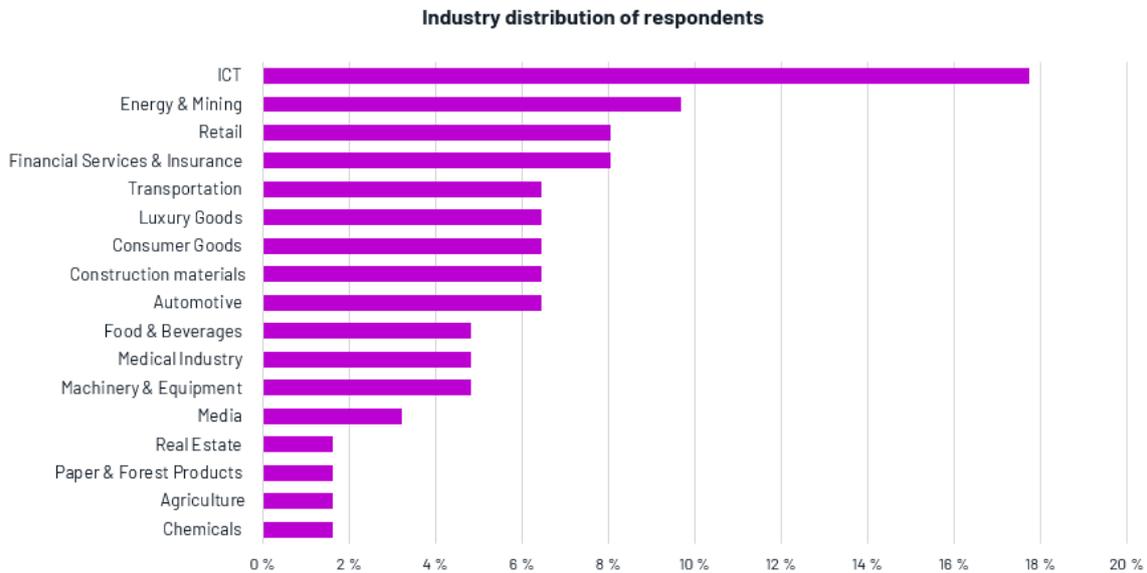
A clear but interesting pattern almost immediately emerged. Most daily transfer pricing challenges are related to data and processes which are inherently technology-related issues. In the ideal world, daily work was grounded heavily in technology, leaving the in-house professionals able to concentrate on more meaningful and value-adding tasks instead of the routine work that currently takes up a significant amount of their time. However, the ways in which transfer pricing professionals currently deal with the challenges posed tend to be the very opposite of technological in nature, consisting mainly of more of the "same-old" and reliance on pure luck of not being audited. Therefore, there is a clear gap between the current state and ideal state but for various reasons the bridge between those is, in most cases, still missing.

Even though this study was more exploratory in nature, the reasons for the existence of this gap became quickly apparent. For example, many of the reasons given related to themes of time constraints, lack of budget, a low amount of respect for the transfer pricing function at the corporate level, a lack of understanding of the technological possibilities and realities and a general inability to find suitable technology that would adequately address an MNE's needs. One interviewee described the situation as follows: "It's like running next to the bicycle, you know where you need to get and you see the bike next to you that would get you there fast, but you are constantly in such a hurry with putting out fires that you are not able to jump on the bike". Suggestions for means by which to bridge this gap are offered in the Conclusions section of this report.

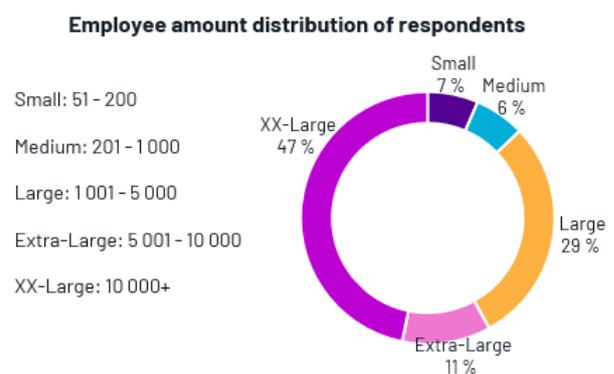
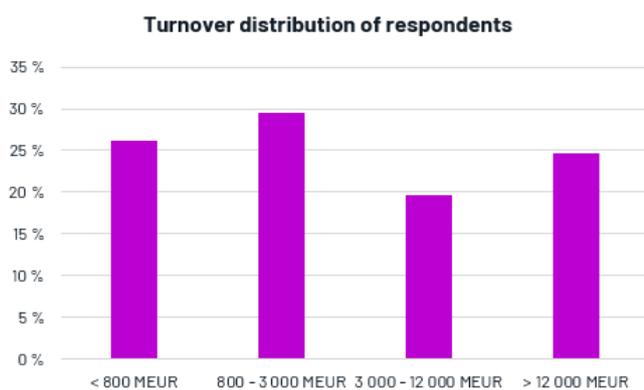
The report is structured as follows. First, we provide some descriptive statistics on the participants. Then we provide insight on the survey answers categorized under Challenges, Mitigation strategies and the Ideal world. We end with Conclusions, where we discuss our findings and provide some recommendations.

2 DESCRIPTIVE STATISTICS

In this chapter, we will provide basic background statistics on the group of respondents. A wide spectrum of different industries was represented by the respondents to the survey. The largest industry groups were ICT, Energy & Mining, Retail and Financial Services & Insurance. This wide range of industries is a perfect example which shows that transfer pricing is relevant to all MNEs across industries.

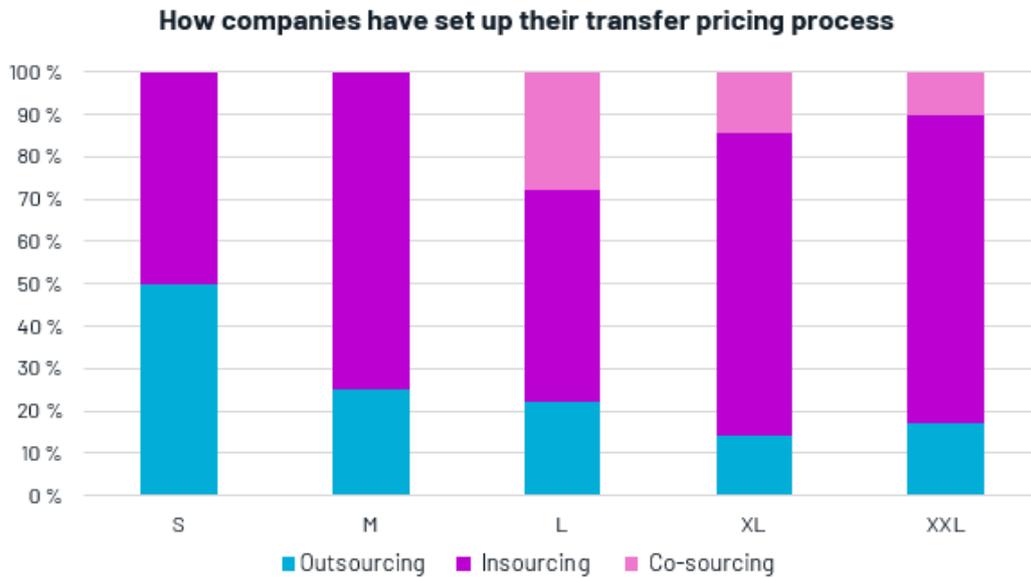


Size distribution of the data was also quite versatile. Below is shown the distribution by turnover and employee count. Almost 60 % of respondent MNEs have more than 5 000 employees. This indicates the clear importance of transfer pricing issues, as in-house professionals were willing to invest their time taking part in a survey from their very busy schedules.



Size distribution affects the way in which current transfer pricing processes are set up between insourcing, outsourcing, and co-sourcing. Only small and medium-sized MNEs tend to rely notably on the outsourcing model. Larger companies, on the other hand, tend to skew towards utilizing the co-sourcing model, relying on outsourcing to handle the more complex compliance and planning tasks as well as audits. However, the data generally supports the intuitive hypothesis that the larger the company, the more control they want to keep in-house to manage transfer pricing processes. In addition to the control motive, cost is also one explanation, as roughly 20% of respondents

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3 DAILY CHALLENGES OF IN-HOUSE PROFESSIONALS

During the interviews ten challenges faced by in-house transfer pricing professionals were identified. These challenges can be clustered into three main categories with associated sub-groups:

- Challenges related to data
 - Data collection
 - Accuracy of local data
 - Data analysis
- Challenges related to processes
 - Communication of transfer pricing matters externally and internally
 - Unstandardized processes
 - Unharmonized documentation
 - Challenges of performing and updating functional analyses
- Challenges related to regulatory environment
 - Regulatory knowledge gaps
 - Tax authorities having difficulty understanding the transfer pricing set up and facts
 - Tax audits

Below, more detailed statistics on each of these categories are provided and the relevant findings are discussed.

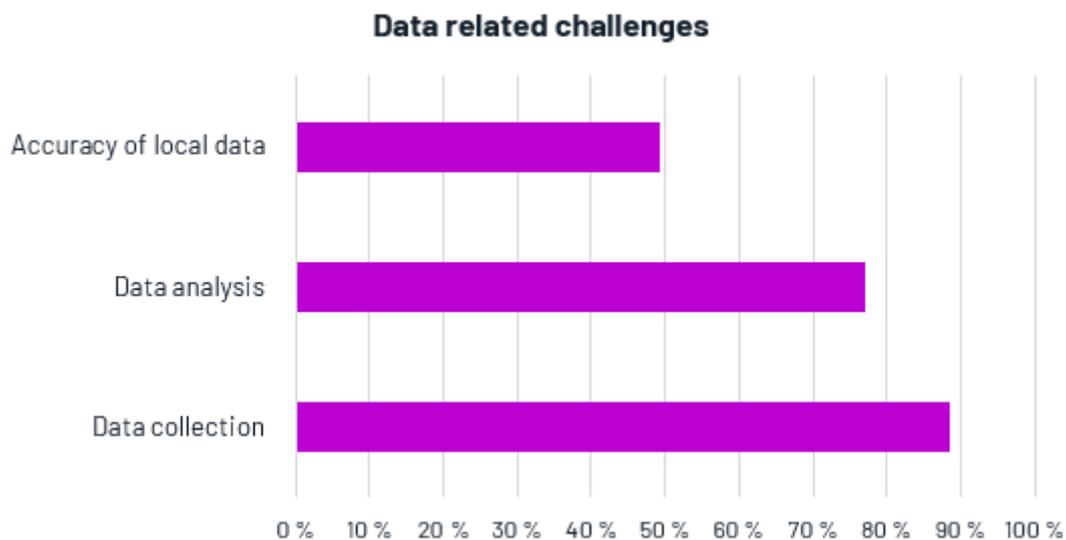
3.1 Data challenges

The cornerstone of any kind of compliance activity is data and data analysis. In transfer pricing, experts deal with a daunting cross-functional set of data related to finances, legal issues, functions, risks, assets, industry etc. It is therefore not a surprise that data problems seem to truly be among the main headaches for in-house transfer pricing professionals.

- 90% of respondents mentioned at least one type of data-related problem to be among their main daily challenges.
- 85% of those who had problems in data collection, also experienced challenges in data analysis.
- Over 50% of companies with at least 1 000 employees have problems in local data quality.

Somewhat surprisingly, companies within the ICT sector are not doing too much better despite being in the data business. Over 80% of them also reported at least one data-related challenge.

The chart below shows how a large share of respondents had different types of data-related problems among their daily challenges.

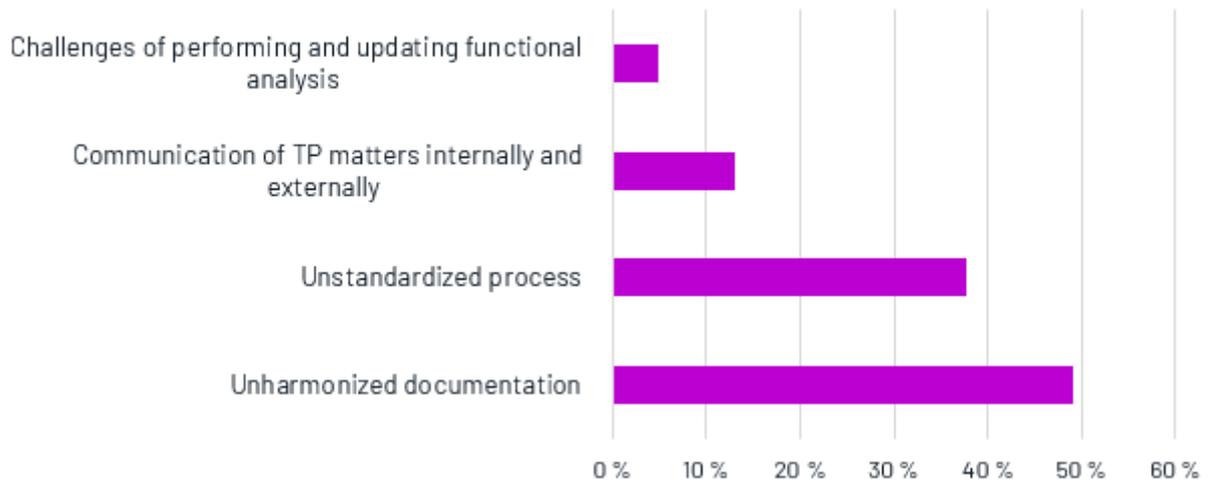


3.2 Process challenges

Challenges related to process vary somewhat more than those concerning data.

- Two thirds mentioned at least one process related challenge.
- Half of smaller companies have problems related to internal and external communication, most likely due to lack specialized in-house resources.
- Most common process-related challenge was unharmonized documentation, with almost half of respondents reporting this.

Process related challenges

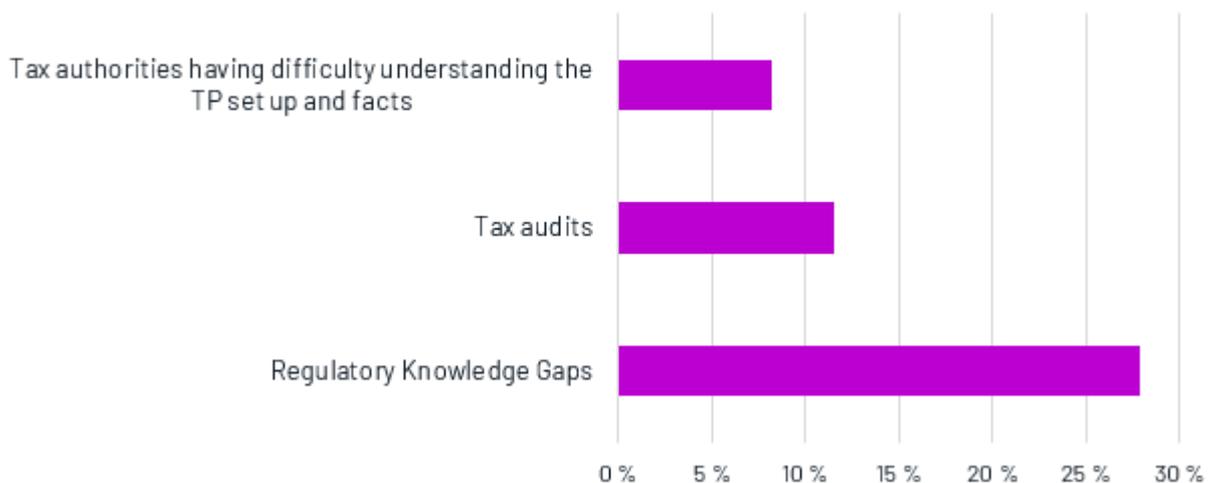


3.3 Regulatory environment challenges

One of the enduring issues raised by the transfer pricing community is the complexity of local requirements in transfer pricing documentation. Quickly changing and increasing transfer pricing regulatory burdens are clearly reflected in the challenges experienced by in-house transfer pricing professionals.

- A regulatory knowledge gap was clearly the most common challenge within this category.
- Overall, communication with tax authorities does not seem to be a major problem as it was mentioned by less than 10 % of respondents.
- More than 60% of respondents mentioned at least one of the below among their daily challenges.

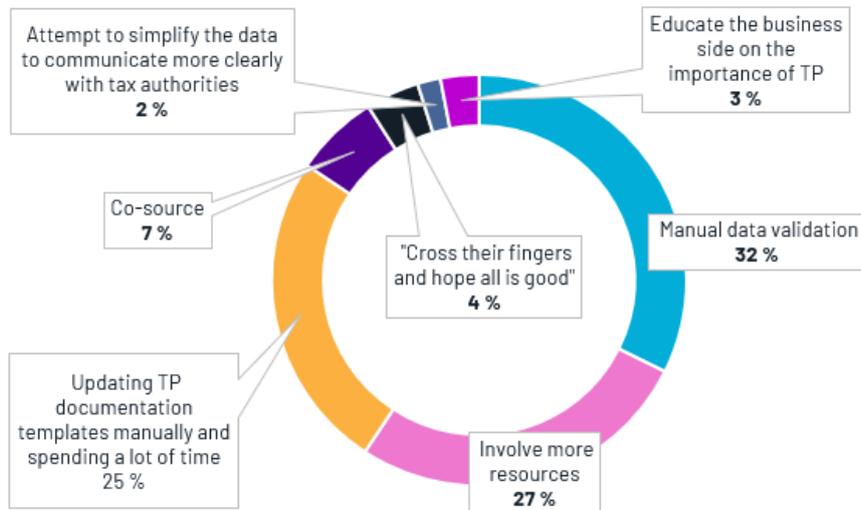
Regulatory environment related challenges



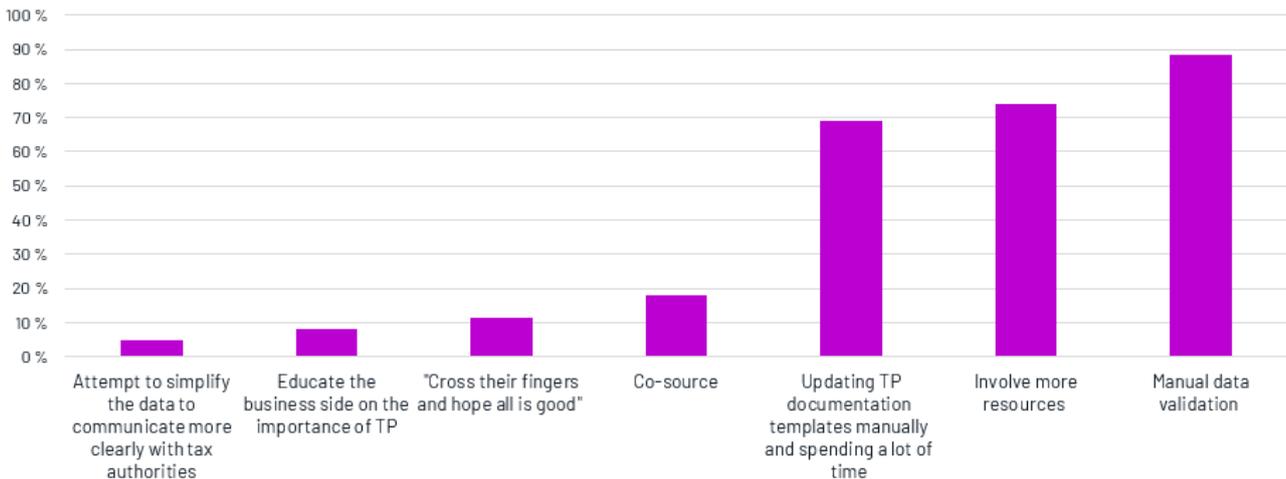
4 CURRENT MITIGATION STRATEGIES

Participants were also asked how they manage to deal with the challenges posed above. While the industry is known to rely on manual practices, the extent of this situation is nevertheless somewhat surprising. Based on the survey data, highly educated transfer pricing professionals almost solely rely on manual work practices to manage the challenges faced in their day-to-day activities. As can be seen in the chart below, over 80% of answers are pure “muscle” strategies, i.e. doing things manually and increasing the resources used. It seems that despite the increasing “tech-talk” within the industry, technological transformation within the transfer pricing world is still very much in its infancy.

Current mitigation strategies - share of responses



Current mitigation strategies - share of companies using the strategy



When looking at the company distribution, it can be seen in the chart above that 70-90% of companies in the sample are using these muscle-type strategies. Only a handful of respondents are using more elegant approaches, such as educating in-house businesspeople on the importance of transfer pricing or simplifying their transfer pricing data so as to ease communication with tax authorities. Somewhat alarmingly, more than 10% of the companies are using the “cross their fingers and hope for the best” approach among their strategies.

5 THE IDEAL WORLD

Respondents were also asked what their ideal transfer pricing set up would be. The responses can be categorized very similarly to the challenges noted above referring to data, processes, and regulatory environment:

- Data in the ideal world
 - Optimized data collection
 - Data visualisation to better understand data
 - One place for transfer pricing data / harmonized data
 - Embed transfer pricing into global ERP
- Processes in the ideal world
 - An ability to prepare documentation automatically in-house
 - More efficiently utilize in-house resources
 - Standardized processes
- Regulatory environment in the ideal world
 - Being able to easily obtain updates on regulatory changes
 - Easier communication with tax authorities
 - Easy and fast ways to adjust to new regulations
 - More experienced tax auditors
 - Less regulation-

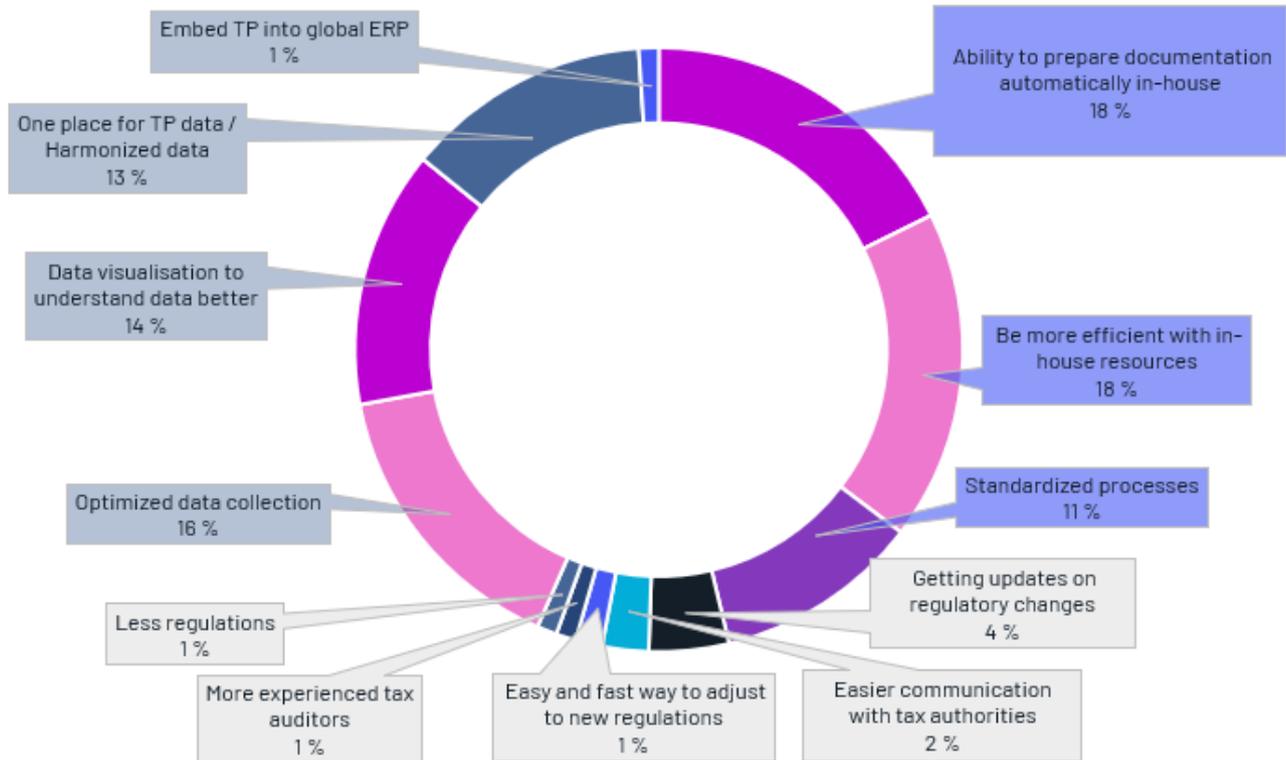
Somewhat surprisingly, only a couple of the respondents envisioned full outsourcing in their ideal world. Apparently, the ability to be in control of the transfer pricing set up, data and process is considered very important.

Data-related wishes (the dark grey-highlighted text boxes in the chart below) constituted roughly 45% of the responses. Data collection, storage and harmonization are in the very early stages of the transfer pricing data flow. A significant amount of improvement in that phase is clearly hoped for as those made up roughly 30% of all responses. Transfer pricing professionals are also increasingly starting to understand the benefits of various analytics and visualisation tools in managing and monitoring their transfer pricing data.

One surprising finding was that only a few respondents mentioned a transfer pricing set up integrated into their company's global ERP system as a component of their ideal transfer pricing world. It can be assumed that this is likely due to an acknowledgment of the time and financial investment inevitably involved, an undertaking not many companies can afford. Such set ups fall under operational transfer pricing systems which typically take 6-18 months to implement and are therefore considerable investments. Benefits from operational transfer pricing systems arise from time savings in transfer pricing calculations, increasing control and decreasing risks.

Transfer pricing data is often seen only as a compliance matter and some respondents complained that the transfer pricing function within their company is undervalued. Economic analyses of internal transactions and the comparison with appropriate external transactions reflects how healthy and profitable a specific activity is. Therefore, there are clear business implications to be utilized from transfer pricing analyses.

Components of the ideal world of transfer pricing



Process-related hopes (the blue-highlighted text boxes in the chart above) constituted almost 50% of the responses. These answers clearly tell the story of the wish to obtain in-house control of transfer pricing processes. This means taking internal responsibility for increasing the amount of the relevant transfer pricing tasks and being able to execute them more efficiently. A natural part of this is also the desire for the standardization of transfer pricing processes, which was also a quite common item on the wish list.

Less than 10% of the responses mentioned hopes related to the regulatory environment (the light grey-highlighted text boxes in the chart above). Most of these were related to the ability to easily obtain updates on regulatory changes and subsequently be able to adjust to them quickly. The miniscule number of respondents hoping for less regulation generally reflects the fact that transfer pricing professionals have grown accustomed to the thought of a heavy and increasing transfer pricing compliance burden. Less regulation was considered unrealistic, even in their ideal world.

6 CONCLUSIONS

There is one big take away that can be derived from our survey:

Most of the challenges in-house transfer pricing professionals face are related to data and processes, in their ideal world these challenges have been resolved with the help of technology but at the moment very few companies are actively progressing to that direction.

As mentioned, one of the respondents described the situation as that of running next to a bicycle. We learned that the reasons for this gap between their current and ideal states relate mainly to 1) time and budget constraints, 2) a lack of understanding of technological possibilities and realities and 3) an inability to find suitable technology. Bridging this gap requires effort from both technology vendors and in-house professionals.

Bridging the gap caused by time and budget constraints

Time and budget constraints will always be a problem in a field such as transfer pricing. A lot of time goes to “putting out fires”, so it is difficult to invest in better processes. However, amidst increasing regulation, in-house professionals must make the mental commitment to update their processes in order to achieve a future-proof transfer pricing set up. It is important to understand that it can always be just a step, and not necessarily a leap. Some companies decide to take the leap and engage in a project for a full end-to-end system where data flows from systems through analytics to documents. Other organizations take a very small first step through structuralizing and standardizing their transfer pricing data and framework and then build from there. It is also important to understand what level of digitalization makes business sense to each company. While full end-to-end data flow might be needed for a large company, a small or medium-sized company could work perfectly smoothly automating only some parts of their transfer pricing process.

Bridging the gap caused by lack of understanding technological possibilities and realities

Some of the hesitation to take the first digital step is because companies do not understand what is possible and what is needed. Moving away from the frustrating but familiar Word and Excel process to new digital tools might seem initially intimidating. It is important to understand that there are many ways to progress on the digital maturity journey depending on resources and readiness. However, waiting is a luxury not available for too much longer given that transfer pricing compliance is moving increasingly towards machine-readable formats. This eventuation will force everyone on-board the digital journey, meaning that it is better to be proactive. At the same time, technology vendors have a responsibility to educate transfer pricing professionals on what is expected from them in the future as well as what is possible. Further, it is important for them to design tools that are intuitive and user-friendly to minimize the burden of transition and ensure that machine-readable data will still simultaneously be in a human understandable format.

Bridging the gap caused by an inability to find suitable technology

In our interviews, we learnt that some of the respondents had made the mental commitment and reserved the time and resources to implement relevant technology but had ultimately failed to find something that suited their needs. Here is a clear message to the technology vendors to listen to the clients’ pain more carefully and build solutions better fitted to respond to those pain points.

Working to bridge these gaps is an essential undertaking to prepare for the future where transfer pricing compliance happens increasingly through machine-readable formats. This change will bring control, reduce risk and also free transfer pricing professionals from strenuous and time-consuming manual work and let them focus on more interesting and value-adding tasks such as planning, monitoring and analyzing, i.e. things that they were educated and trained for.