

Transfer Pricing Documentation



Multinationals of all sizes are required to be much more transparent about their allocation of global profits.

This change necessitates that groups with overseas operations robustly defend their transfer pricing policies with compliant transfer pricing documentation.

Are you prepared?



How would your business respond to the following question, taken from a recent enquiry initiated by HMRC?

“ when [the responsible person] signed the declaration and submitted the tax return, what measures were undertaken to ensure the related party transactions for [UK Company] were in line with the arm’s length principle?

- The only way to ensure that this can be adequately answered is through the preparation of robust transfer pricing documentation.
- Failure to answer the above may result in HMRC seeking to levy a 30% penalty for careless behaviour. In more serious cases, this can be up to 100% of the tax in question
- Furthermore, countries like Italy have administrative penalties of 90-180% of the additional tax due. It is therefore important to ensure that compliance obligations are met across all jurisdictions.

What documentation do I need?



There are **three separate documents** that need to work together to articulate the story of the group on where value is derived and support why the business’s transfer pricing policies are robust.

01 Local files

This acts as the **first line of defence** and is the document most tax authorities will request first. Local files are familiar, however the requirements for their contents are now more prescriptive. They analyse and explain why the transfer pricing arrangements at an entity level are consistent with the arm’s length standard.

This is achieved through a functions, risks and assets analysis, as well as an economic analysis and, typically, benchmarking studies. Many jurisdictions also impose additional local nuances and requirements over and above the OECD standard; few require less information than this standard.

02 Group master file

This document provides an overview of the Group through a transfer pricing lens and is particularly important for complex businesses operating across multiple territories.

It is a group-wide document that should be made available on request or submitted annually, which sets out key qualitative economic analysis of the group. This will include the location of key management and other significant people functions; IP holding policies; key intercompany transactions; and how the group is financed.

In some territories an annual confirmation needs to be made in the tax return that a master file has been prepared (e.g. Netherlands).

03 Country – by – country reporting:

A further, group-wide document that provides key financial information to the relevant tax authorities, generally for groups with global turnover above €750 million.

The form is submitted annually and will be used by relevant tax administrations to assess your group's perceived transfer pricing risk. We expect to see a significant increase in the number of audits as a direct result.

The key challenge is ensuring a co-ordinated approach which provides consistency across all three facets.

What to do next



KPMG's team of transfer pricing professionals would be delighted to talk to you about the transfer pricing documentation requirements for your business.



Our regional teams have extensive practical experience of advising on transfer pricing policies and preparing transfer pricing defence documentation across a wide range of business sectors and territories. Our team includes former tax authority transfer pricing specialists and industry tax professionals with considerable experience of dispute resolution which enables us to support you through the entire transfer pricing lifecycle.

Why now? The benefits of compliance



Tax authority investigations

The number of tax authority audits focusing on transfer pricing is on the rise globally. HMRC has increased the number of TP professionals to over 365. This has resulted in revenues from transfer pricing enquiries doubling since 2014/15 to £1.62 billion for 2017/18.



Tax governance and control

Transfer pricing is on the internal audit and board agenda more than ever. Transfer pricing documentation is a key part of a company being able to sign off an unqualified SAO certificate in each period.



Penalty protection

Where transfer pricing documentation is absent, HMRC is likely to levy penalties for careless behaviour. Overseas tax administrations are likely to apply similar rigour. For example, the only way of avoiding penalties in the US is through the preparation of 'contemporaneous' transfer pricing documentation that is in place at the time the tax returns are filed.



External audits

In many jurisdictions, external auditors will request to see transfer pricing documentation when signing off financial statements. Having robust documentation will assist with the year-end process.



Clean exits

Transfer pricing questions are becoming more prevalent in M&A. Having robust existing transfer pricing documentation can save a target's management time and help to limit price chips.

Busting some of the most common myths



Our experience suggests that a number of organisations have not appreciated the extent of the compliance burden placed upon the taxpayer to demonstrate that their transfer prices are arm's length. A few common myths are busted below.

“ Our transfer pricing documentation was prepared last year; this will cover me for the next three years

Incorrect. The new standard mandates that transfer pricing documentation is prepared for each period of account to support the tax filings in each country. Some jurisdictions go further and request documentation to be submitted with the returns or confirmation within the tax return that TP documentation exists.

“ We have legal agreements in place, surely that is enough documentation for our transfer prices

Incorrect. Whilst legal agreements are important, they only provide the starting point for the transfer pricing analysis. Transfer pricing documentation must analyse whether the pricing is consistent with the arm's length standard and this can only be done by looking beyond the terms of intercompany agreements and performing a rigorous functional and economic analysis.

“ All my intercompany transactions are with companies resident in treaty partner countries, which means if there is an audit I can invoke the treaty and then the tax authorities will agree on the same price and the group is unlikely to be worse off.

This fails to take into account penalties, interest and tax rate differentials. Not all treaty parties apply the dispute resolution obligations consistently and the process can be lengthy and costly, in practise the process is uncertain and does not always result in a mutual agreement.

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