

# Hyperion Focus 2015

## Transfer Pricing for Beginners

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# Agenda

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- A brief history of transfer pricing
- Fundamental concepts
- Why transfer pricing is important
- How to determine “arm’s length” pricing
- Situations where transfer pricing rules apply
- Practical issues
- A brief glimpse into the future
- Q&A

# A brief history of transfer pricing

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- 1920's – IRS commissioner has power to adjust accounts of related parties
- 1935 – first introduction of arm's length principle in US rules
- 1951 – UK introduces first transfer pricing legislation
- 1968 – US codified arm's length pricing methods
- 1979 & 1984 – OECD reports on transfer pricing and MNE's
- 1994 – introduction of modern US transfer pricing, S482
- 1995 – first OECD guidelines published
- 1998 – UK modernises legislation and requires documentation
- 2004 & 2005 – domestic transfer pricing in UK and Denmark
- 2012 – UN transfer pricing guidelines
- 2013 – G20 endorse OECD BEPS action plan

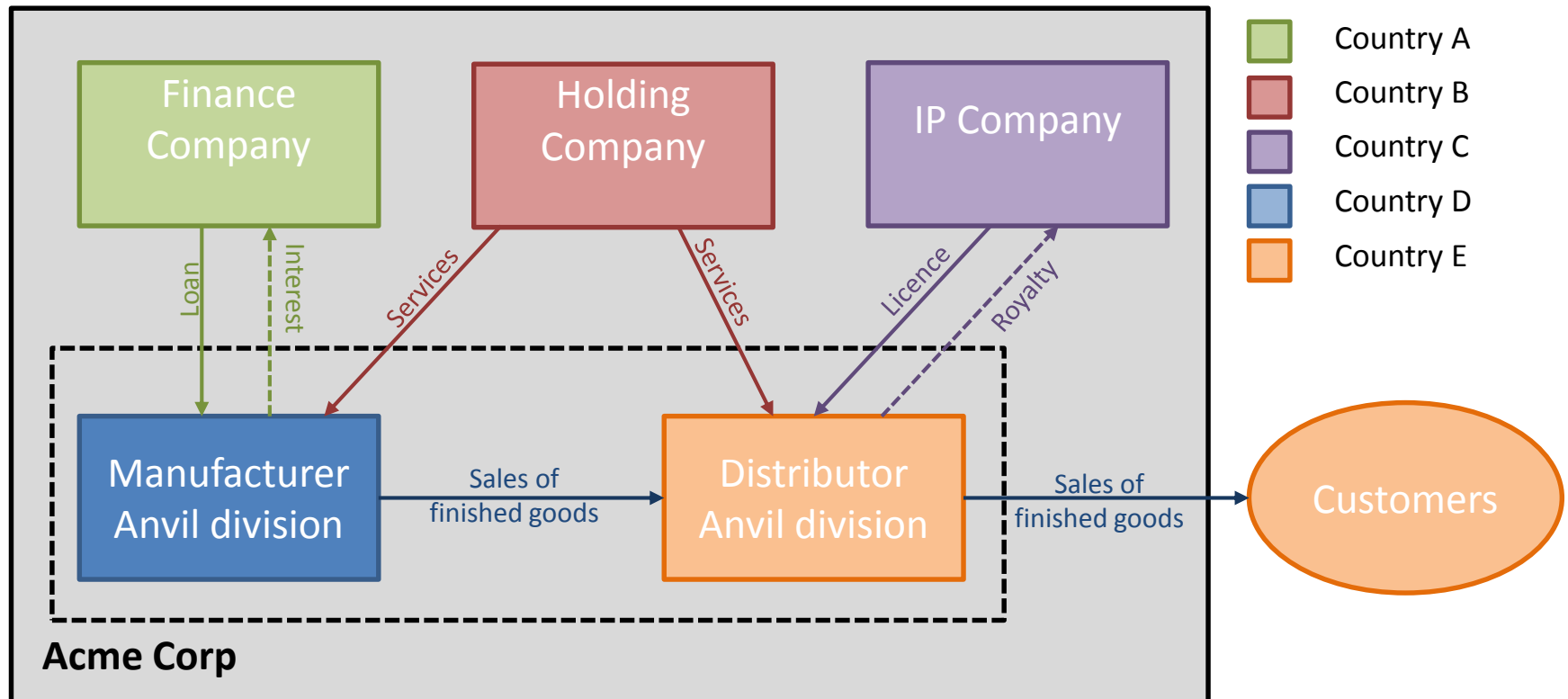
# Fundamental concepts

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- The cornerstone of transfer pricing is the  
**“arm’s length principle”**
- The amount of profit on transactions between connected parties should for tax purposes be the amount of profit that would have arisen if the same transactions had been executed by unconnected parties
- This principle is enshrined in OECD guidelines and followed by the tax authorities of most OECD members
- Many countries require MNE’s to maintain documentation to demonstrate inter-company transactions are at “arm’s length”
  - Typically requires extensive analysis and benchmarking of comparables
- Advance Pricing Agreements can be negotiated with some tax authorities

# Why transfer pricing is important

- Much international trade takes place within MNE's
  - Estimates vary widely from 30% to 60% or even 70% of international trade
- NGO's allege \$00's bn lost tax revenues due to mispricing or transfer price manipulation by MNE's



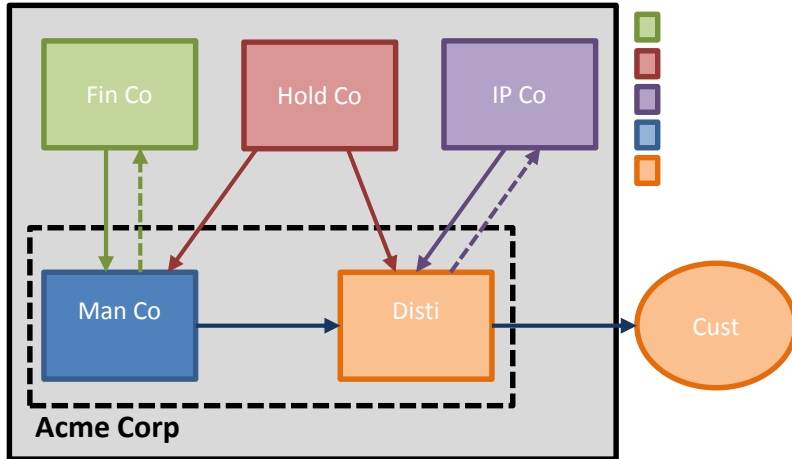
# How to determine “arm’s length” pricing

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- Five methods for determining arms length pricing are recognised in the OECD guidelines and US transfer pricing regulations
- Comparable uncontrolled price - “CUP”
  - Price of comparable transaction between independent parties
- Resale price method - “resale minus”
  - Purchase price of goods for sales and distribution entities
- Cost plus
  - Sale price of goods for manufacturers, pricing of intra-group services
- Transactional Net Margin – “TNMM”
  - Compare with the return earned by comparable independent enterprise
- Comparable profits – “CPM”
  - As TNMM
- Profit split – “PSM”
  - Not a recognised method but often asserted or resorted to in disputes

# Situations where transfer pricing rules apply

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- Four arms length prices to determine
- Three bi-lateral and one tri-partite relationships to consider
- Goods
  - CUP for anvils
  - Manufacturer - cost plus or CPM
  - Distributor – Resale minus or TNMM

- Services

- Must be similar to a service an independent enterprise would be willing to pay for or perform itself.
- Usually cost plus for Hold Co and commonly challenged by tax authorities of Subs.

- Finance

- Interest rate AND amount of loan must be arm's length
- Credit rating of borrower and parental guarantees need to be considered

- Marketing intangibles

- Very difficult to determine arm's length price, typically low % royalty on sales
- Tax authorities will look very critically at economic substance of IP Co

# Practical issues

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- CUP's are great in theory but extremely rare in practice
- Managing transfer pricing rules and risk requires considerable skill and resource
  - Large volumes of data/information, functional analysis, benchmarking, monitoring change & keeping documentation up-to-date
  - Ensuring pricing adjustments are timely and accurate
- Third party pricing isn't perfect but tax authorities review related party pricing with the benefit of hindsight
- “Secret comparables” – data tax authorities have gathered from other audits, disputes and APA negotiations
- Tax authorities can view/analyse transactions differently
  - Mutual agreement procedures not readily accessible and/or expensive
- APA's are difficult, time consuming and costly to negotiate

# A brief glimpse into the future

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- Country-by-country reporting
  - Currently being legislated as an outcome of BEPS
  - New risk assessment tool for tax authorities
- SAF-T – standardised electronic data format to facilitate “e-audit”
- Codes of conduct for large business taxpayers
- Consolidated Corporate Tax Base (“CCTB”) in EU
- Global unitary basis of taxation for MNE’s
- **Increasing risk of double taxation for MNE’s**

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Q&A

# Andy Oliver

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Andy is currently European Senior Tax Manager for Samsung Electronics, responsible for the oversight of transfer pricing and corporation tax across Europe. He has over 30 years experience of corporate taxation for MNE's in HMRC, the Big 4 and in-house.

Andy has a particular interest in the application of technology to improve the control and efficiency of tax compliance and risk management processes. He firmly believes in leveraging finance systems and processes for tax and has led numerous projects to bring closer integration to tax and finance processes.

# Thank you!

