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Operational Transfer Pricing (OTP)

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OTP encompasses all components that are critical for accurate implementation of transfer pricing (TP) policies at both transactional and entity level. The overarching objective is to align legal entity statutory (GAAP) financial statement outcomes and tax returns with the arm's length standard.

What are the benefits of having a robust OTP framework for transfer pricing implementation?

The expanding remit of transfer pricing legislation and increased scrutiny from tax authorities means managing transfer pricing risk as part of the Group's overall tax position has never been more important.

In this context, setting the intercompany pricing policies is just the starting point. It is equally (if not more) important to have a robust OTP framework to accurately implement transfer pricing policies to align legal entity financial statement outcomes and tax returns with the arm's length standard. The benefits of having a robust OTP framework are:

- Reduced cost of compliance (*see next question for a non-exhaustive list of impacted areas*)
- Clear evidence and defence in case of controversy
- Enhanced visibility and audit trail of transfer pricing policies
- Increased collaboration across functions (such as tax and finance)
- Credibility in front of internal (eg CFO) and external (eg tax authorities) stakeholders.

What areas of tax and financial statements are impacted by inaccuracies in transfer pricing implementation?*

- Data included in Masterfile, Local files
- Data included in International dealings schedules or equivalent local TP filing obligations
- Data included in submitted tax returns
- Tax provisions in statutory accounts
- Compliance with Senior Accounting Officer (SAO) obligations
- Customs duty valuation, VAT and withholding taxes
- Post year-end transfer pricing adjustments could impact the Balance Sheet such as on stock, work-in-progress values
- BEPS 2.0 – Pillar One (*if enacted*) – reallocation of profits to market jurisdictions requires accurate TP calculations at legal entity and country level
- BEPS 2.0 – Pillar Two – reporting requirements and GIR (Global Income Reporting) requires clarity and transparency of financial information and accurate transfer pricing implementation is a critical aspect of this
- Public CbC – EU has recently introduced Public CbC reporting requirements. Correct implementation of transfer pricing is important to avoid errors in public reports.

**** Please note that this is not exhaustive.***

When is the right time to check that transfer pricing policies have been implemented correctly?

Transfer pricing compliance is a cyclical process which needs to be tested annually. It is important to check that transfer pricing policies are implemented accurately before the finalisation of legal entity statutory (GAAP) financial statements on an annual basis.

If implementation checks and reviews are deferred until after accounts are closed and the resultant adjustments are only made as 'computational' adjustments in the tax return, the risk of double taxation increases because downward transfer pricing adjustments that reduce taxable profits or increase losses are not permitted in many jurisdictions such as the UK.

In the UK, this is due to a transfer pricing principle known as **'one-way street'**.

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What are the penalties for incorrect implementation of transfer pricing?

Demonstrating and evidencing the level of care taken to calculate the arm's length return for filing purposes is highly relevant for penalty determination. Tax authorities expect Groups to have clear processes, responsibilities, controls and documentation in place to evidence accurate implementation of transfer pricing policies to avoid '***carelessness***' related penalties.

What are the common implementation errors encountered by tax authorities?*

- Financial information used for transfer pricing calculations that do not reconcile with statutory accounts
- Material costs/revenues not included in target margin calculations
- Incorrect treatment of exceptional/extraordinary items
- Non-transfer pricing consequences of issuing correction invoices/credit notes such as customs valuations not considered
- Transfer pricing adjustments performed on a net basis which if considered separately may not be allowed, for example, due to UK's one-way street principle
- Transfer Pricing calculations based on management accounts or Group GAAP accounts which do not take account of material GAAP differences, such as central cost allocations excluded from entity level management accounts, year-end audit adjustments
- Testing of arm's length return over multiple accounting periods when the requirement is to test on an annual basis
- Not considering the impact of transfer pricing adjustments on Balance Sheet items (for example, stock and work-in -progress)
- Using forecast data to calculate transfer prices and no adjustments made for differences with actuals.

Why do tax authorities encounter frequent transfer pricing implementation errors?*

Tax authorities frequently encounter transfer pricing implementation errors because many Groups lack:

- **Defined processes** for transfer pricing implementation (such as step-by-step guides for Finance staff who calculate transfer prices, sign-off processes)
- **Controls and checks regarding transfer pricing as part of financial reporting cycles** (such as, checks and reviews on a regular basis by a competent member of staff or advisor who hasn't performed the calculations, process automation with built-in checks)
- **Audit trail tracing numbers (Data)** within the transfer pricing report and international dealings schedule (or equivalent local TP filing obligations) to statutory accounts and tax returns
- **Necessary skills and experience or training** for staff or third parties which perform these calculations.

Why do Groups struggle to get their transfer pricing implementation right?

Large data repositories, dated ERP/EPM systems, frequent staff changes, limited resources, and poorly defined processes/procedures and controls result in significant mistakes in the implementation of transfer pricing policies.

**Please refer to next page for HMRC's views on this*

Operational Transfer Pricing (OTP) and HMRC's GfC7

What do HMRC's Guidelines for Compliance (GfC7) say about transfer pricing implementation?

HMRC issued Guidelines for Compliance for transfer pricing (GfC7 - Help with common risks in transfer pricing approaches) in September 2024. These guidelines set-out HMRC's expectations on best practice for Transfer Pricing Compliance.

According to HMRC, accurate implementation of transfer pricing policies is a critical aspect of operating an effective transfer pricing compliance framework. Accurate implementation of transfer pricing policies not only helps with penalty protection; it also helps in complying with important statutory obligations such as:

- SAO (Senior Accounting Officer) obligations of making sure that a company establishes and maintains appropriate tax accounting arrangements, including for transfer pricing
- Ensuring that the tax return is correct and complete
- Data included in Masterfile and Local File documentation is accurate.

These carry penalties for non-compliance.

Do you recognise any of the following? If yes, you may need some OTP support (see GfC7)

- We struggle to compile a full list of intercompany transactions for year-end reviews and TP documentation and this data often does not reconcile to statutory accounts (GfC7,1.4.3)
- TP is not important for management reporting purposes therefore we do not get support from Business Finance or IT teams on intercompany queries and our TP calculations do not reconcile to GAAP financial statements (GfC7,2.4.1)
- We have a simple limited risk distribution and services model, but several subsidiaries are loss making, not hitting intended transfer pricing policies and/or have large quarterly or annual transfer pricing adjustments (GfC7,2.4.1)
- We are not confident in our segmentation process therefore cannot support TP policies on a functional basis (GfC7, 2.4.1)
- We have a very manual TP calculation process, and every financial controller uses their own version of the spreadsheet to calculate TP charges resulting in errors in invoiced or recharged amounts (GfC7,1.2.2)
- We often process net transfer pricing adjustments that create indirect tax or withholding tax issues (GfC7,1.2.2)
- Due to the timing of our checks and review process we are forced to process transfer pricing adjustments through accounts of subsequent period, and this distorts profit and loss and occasionally balance sheet for that period (GfC7, 1.4.2)
- Our intercompany flows are resulting in irrecoverable indirect taxes (GfC7,2.4.2)
- We use forecasts to establish transfer prices at the beginning of the year but invariably end up with large year-end adjustments or retrospective adjustments as actual profits or losses fall outside the benchmarked range (GfC7,1.2.2).

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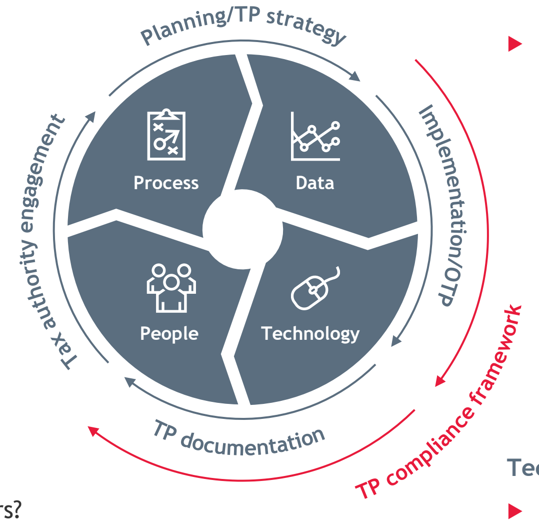
OTP encompasses all components that are critical for the successful implementation of TP policies

Process and controls:

- What is the end-to-end TP process and what sub-processes exist for each intercompany transaction?
- How well is the process documented?
- Are there adequate controls to ensure accurate outcomes?

Data:

- What data is needed to implement/execute/document a TP policy and where is it located?
- Is this data available at the right time and in the format required?
- Is the TP calculation updated for changes in the input data?



People:

- Who are the OTP process owners?
- Is there good collaboration and support between departments that both rely on and support the TP lifecycle?
- Is there adequate training for those tasked with the day-to-day implementation/execution of TP calculations?

Technology:

- Do you use anything other than spreadsheets for TP calculations?
- Does current technology hinder or help with the OTP process?
- Are there opportunities for increased efficiency? Are opportunities being missed due to technology limitations?

Operational Transfer Pricing (OTP)

How can BDO help

Through collaborative workshops, proactive compliance frameworks, in-depth documentation and reporting and technology integration, BDO empowers clients to navigate the complexities of OTP/TP implementation effectively.

Key elements of an OTP engagement include:

1. Establishing processes, controls, and governance
2. Defining stakeholder responsibilities (RACI)
3. Identifying source data
4. Establishing standard templates for TP calculations
5. Implementing automated technology solutions

BDO's OTP service offerings

Our services are adaptable and customised to meet your specific requirements.

- ❑ If you have an OTP framework and would like a high-level risk review: see our **Health Check/Diagnostic review service.**
- ❑ If you would like your OTP framework to be reviewed in detail (in part or full): see our **TP assurance service**
- ❑ If you do not have an OTP framework and would like to design and implement a new one: see our **Implementation advisory service**
- ❑ If you use non-standard spreadsheets for OTP calculations and would like more standardisation and built-in checks: see our **Modelling service**
- ❑ If you would like to explore technology options to automate your OTP calculations: see our **Technology assessment, design, implementation and support service**
- ❑ If you lack resources and would like to outsource your OTP calculations: see our **Managed service solutions**

Health Check Review/ Diagnostic (GfC7, SAO/ BRR+ readiness)	Gap identification in existing OTP/ transfer pricing implementation framework by comparing with HMRC GfC7, BRR+, SAO requirements for TP implementation.	**Modelling**	Designing, building, testing and delivery of TP calculation models using desktop technology (eg, Excel, Power, Query Toolkit, Alteryx, Power BI).
TP assurance	Review existing OTP/ TP implementation processes, controls, calculation frameworks and provide assurance that appropriate controls have been established with the aim of adequately managing your transfer pricing risks. This can be shared with internal and external stakeholders (including tax authorities and auditors).	**Technology assessment, design, implementation and support**	Review of suitable technology options and support with implementation of chosen technology option. The implementation support services include development of design requirements, technology build (or oversight), training, overall project management.
Implementation Advisory	Process documentation preparation (eg, transaction lists, TP policy statements, segmentation template) and TP operating manual which will include step-by-step guide for TP calculations including review processes/controls, RACI framework.	**Managed service solutions**	Preparing transfer pricing calculations as a managed service.

Operational Transfer Pricing (OTP)

Key contacts

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Paul heads BDO’s Transfer Pricing Team in the UK. He assists clients with Transfer Pricing studies and documentation exercises, plus the design and implementation of value chain models, as well as dealing with HMRC and tax authorities internationally on inquiries and disputes, including supporting on MAPs and APAs.

Paul’s clients range from those taking first steps in establishing overseas operations, through to global businesses outsourcing their worldwide Transfer Pricing compliance. He has in-house experience and perspective from time in a Transfer Pricing role within a FTSE100 business and understands the importance of providing grounded, practical advice.

Meenakshi Iyer

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Meenakshi is a transfer pricing partner, based in BDO’s London office. Meenakshi has experience of supporting clients through the entire transfer pricing lifecycle of planning, implementation, documentation and tax authority engagement (enquiries, APAs, MAPs) for all types of intra-group transactions including financing transactions.

Meenakshi leads BDO's Operational Transfer Pricing (OTP) proposition. In this role, she supports her clients in translating their transfer pricing policies into accurate legal entity financial statement outcomes by developing and implementing robust processes, governance and controls, relevant automation and managed service solutions.

Simon Wood

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Simon is an international tax partner specialising in transfer pricing. His primary focus is compliance including documentation, risk management and operational transfer pricing. He also helps groups work through business change and international expansion, designing and adapting transfer pricing policies to suit the specific needs of the business.

He has significant experience working with groups of all sizes and across many sectors, with 15 years prior experience working in a Big 4 firm and, more recently, nearly 4 years of experience leading on large and complex transfer enquiries as an HMRC senior international tax specialist. During that time, He was also a member of HMRC’s ‘Guidelines for Compliance’ technical drafting team and an international regional governance group member.

FOR MORE INFORMATION:

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