

Transfer Pricing Software: A Market Perspective

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The use of transfer pricing software is not a recent development within the industry. Transfer pricing software packages were initially designed to automate rudimentary transfer pricing activities such as benchmarking and documentation. The software developers claimed that a revolution would happen in the market, where software would empower multinational enterprises (MNEs) to take responsibility for their own transfer pricing; and at the same time reduce costs of outsourcing to external consultants.

However, since their release over a decade ago, many of the efficiencies promised by software developers have not materialised; and the 'revolution' of the transfer pricing industry was not forthcoming.

It is through these observations that Transfer Pricing Associates ('TPA') recognised a gap between what software developers could deliver and what functionality MNEs expected the software to perform. Thus, to further analyse why corporates have shied away from this software, TPA surveyed the in-house tax professionals of twelve multinational companies during 2008 to collate information on their experiences and perceptions of transfer pricing software, as well as how in-house professionals manage transfer pricing for their organisation.

This article summarises the major findings of the survey TPA conducted.

1 Survey findings

1.1 Participants

The 12 respondents were from the headquarters of each of the multinational companies surveyed. Each respondent was interviewed separately by TPA on a range of topics, including:

Survey topics
Types of transfer pricing reference materials are required in-house
The use of templates for activities such as data gathering, report writing, etc.
The use of external consultants
Their experience with transfer pricing software packages
Design and management of their transfer pricing system between headquarters and their affiliates
The approach of documentation within their group (i.e. use of the masterfile concept) and the support required
How economic analysis and benchmarking is approached within their organisation
The existence of risk management framework within their organisation and how it is administered

Table 1 - Topics discussed with respondents

The multinational companies were from a variety of industries with headquarters located in several different locations worldwide.

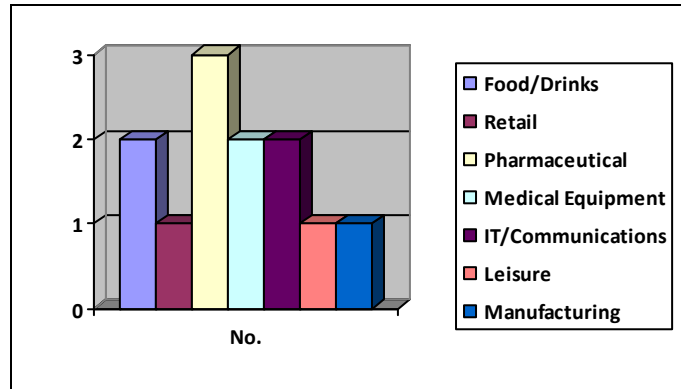


Chart 1 - Industry Types of Respondents

The respondents come from various professional backgrounds including tax, accounting and consulting, and ranging in experience from a few to more than 15 years. All participants have transfer pricing responsibilities within their current roles. In the past, the majority of respondents have used external consultants to fulfil (central & local) documentation requirements, economic analysis (e.g. benchmarking) as well as discussing specific transfer pricing issues (such as restructurings or tax controversy). The frequency and extent that respondents outsource their transfer pricing is dependent upon the experience of the in-house expert and their internal resources. The respondents were generally satisfied with the level of service provided by their external consultants.

1.2 Potential for software use

Only five of the respondents have had prior exposure to using transfer pricing software. In particular, these respondents have had experience with a well-known software solution, which resulted in mixed reviews. One respondent was not happy with this solution and changed to another service provider. The other four respondents were frustrated when they wanted to perform a benchmarking exercise within the software. No short cuts were available to conduct a defined piece of analysis only.

The remaining seven respondents have had no prior use of transfer pricing software; however two were currently considering subscribing to one of the current software solutions in the market.

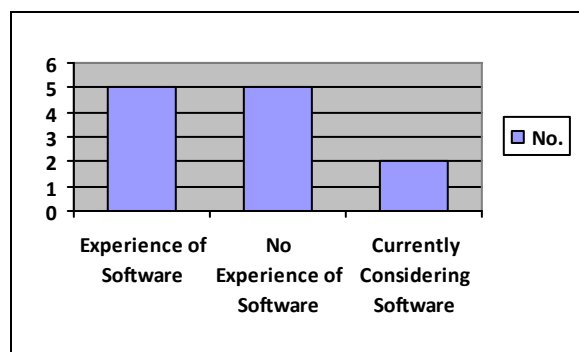


Chart 2 - Experience of Software

The respondents agreed the norm increasingly in transfer pricing is to centrally design and manage a group's transfer pricing system at the headquarters of the multinational. The structure is subsequently implemented by the affiliate companies worldwide. The role of the local transfer pricing manager is to implement this centrally designed system in line with the local transfer pricing laws and requirements. The level of external support required by the local affiliate is dependent upon the detail required by the local tax administration, as well as the relative experience of the local professional.

In line with this structure, the majority of respondents would consider increasing their in-house transfer pricing activities to include routine documentation of these systems, thus reducing the need for external consultants. One respondent has implemented a transfer pricing software package based on this reasoning; however, many respondents are reluctant to follow suit due to constraints on their

in-house transfer pricing experience and resources within the group. They were also sceptical on the level of internal and external support that these software packages seem to require.

1.3 Masterfile approach

It was identified that over half of the respondents have implemented a form of the masterfile concept outlined by the OECD, facilitated by a centrally designed transfer pricing system. One respondent stated that the use of transfer pricing software minimises the time required to complete this more routine documentation and compliance work, allowing him to focus on more technical and complex transfer pricing issues. Generally, a centralised masterfile is completed by external consultants and loaded on the software. All local country files and minor amendments to the masterfile¹ in subsequent years can be conducted through the transfer pricing software. The role of the local affiliate entity is to draft the local country file within the software to meet its country’s local transfer pricing requirements.

All respondents indicated that to support the use of the software, technical and application support should be offered “24/7”. In this respect, respondents gave specific requirements for assistance which is illustrated in the table below.

Documentation assistance
Local country support on specific TP regulations within their local country
Quality review of finalized TP documentation
Assistance substantiating economic analysis when outside of the range
Assistance in pricing intercompany loans
Translations into other languages
Agreement templates
Industry analyses
Financial testing
Access to Royalty Agreements
Check of the legal situation for extraordinary cases (especially foreign law)
Audit and track the development of transfer pricing to allow visibility of the process

Table 2 – Support required for documentation undertaken by respondents

1.3.1 Benchmarking and Economic Analysis

The respondents were also requested to outline the types of transfer pricing transactions that currently exist within their group. The respondents described the following types of intercompany transactions:

- Buy/sell of tangible products
- Design and maintenance of IP
- Production
- Sales and purchase of services
- Loans
- Marketing expense support
- Head office expenses
- Product trainings
- IT services

¹ Minor amendments are defined in this context as updates to the masterfile for a particular year, which do not include significant changes to functions, risks or assets employed. Significant changes to the business would require a redrafting of the masterfile and would require assistance from external consultants.

All respondents have had prior experience with economic and benchmarking analyses for the transactions within their organisation. However, although each respondent has some exposure to this work, all respondent stated that if they were to conduct these studies in-house via the use of software, they would require expert support to substantiate the results (i.e. when results are outside the range, interpretation of results with reference to their industry, as well as assistance in more complex analyses such as intercompany loans).

Furthermore, three of the respondents would consider the purchase of external databases for in-house benchmarking exercises. However the upfront cost and the frequency of their use were key factors in their final decision. The most common external databases known by respondents were published by the Bureau Van Dijk.

1.4 Risk Management

Transfer pricing risk management is a growing area of responsibility for MNEs in recent years. All respondents interviewed indicated that they had varying transfer pricing risk exposure. These are outlined in the table below.

Transfer pricing risks
Audit focus on buy/sell transactions
Lack of documentation and intercompany agreements
Incorrect documentation
No benchmarks in place to substantiate arm's length requirements
Outstanding issues with tax authorities

Table 3 – Types of transfer pricing risks outlined by the respondents

Although all respondents have highlighted transfer pricing risks for their group, the management of these risks have been conducted in various ways. This is illustrated in the graph below.

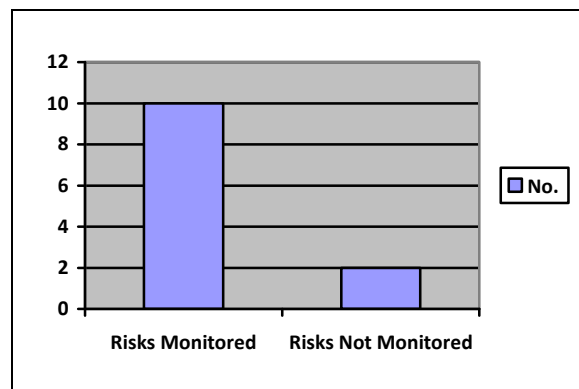


Chart 3 - Risks Monitored within an Organisation

Two respondents companies had not dealt with these risks at all, while the remaining ten respondents have undertaken various initiatives to mitigate these risks, which includes:

- Enlisting an external consultancy to conduct a global documentation exercise where a portion of the work would be to advise on risks;
- Dealing with risks on an aggregate, or case by case basis;
- Showing their TP documentation and examples of pricing to tax administrations for acceptance²;
- Measuring risks by country and entity, as well as by transaction and making an assessment of their exposures.

² It was also discovered that more than half of the respondents have had discussions with tax authorities on transfer pricing.

Three of the respondents interviewed stated that they did not have a formal risk management framework in place. Of the remaining respondents, the majority have constructed their risk management framework in line with the US FIN48 requirements; and was developed in-house or by an external consultant. These frameworks were generally monitored on a quarterly basis.

2 Conclusion

2.1 Defining the need

In conducting the survey with the 12 respondents, TPA has concluded that MNEs recognise the benefits that transfer pricing software packages can provide. However, all respondents recognise that a software package cannot fully replace the role of an advisor or transfer pricing expert. The respondents realise that these software packages can certainly enhance the role of an in-house specialist by providing efficiencies to routine activities such as compliance documentation and benchmarking. This in turn allows them to focus on more value adding tasks; as well as decreasing the requirement for outsourcing to external consultancies. This is particularly beneficial where multinationals are cost sensitive.

2.2 What is Out There?

The respondents believe that many of the current software packages fall short of providing an adequate solution due to their current level of support. Moreover, these packages are generally supplied without support from adequately skilled transfer pricing professionals.

Furthermore, these products have been criticised due to exaggerated claims by their developers who have asserted that their products are capable of providing multiple transfer pricing solutions for planning, compliance and defence. However, it is the firm belief of the respondents that these software packages are suited predominantly for compliance purposes only.

2.3 Survey Results

The survey highlights that for a credible software solution to be created, it must be an integrated solution accompanied by a strong technical transfer pricing support team. Transfer pricing software packages are optimally employed when used for compliance work, or where companies are in a 'constant state' within their business cycle.

The current intelligence of transfer pricing software packages is such that they are incapable of dealing with the various technical aspects required for analysis when a change within the business occurs. Multinational companies must recognise this limitation when employing and integrating a transfer pricing software solution for their corporation.

Transfer Pricing Associates (TPA) is the leading independent provider of global transfer pricing services and part of the TPA Global group. The TPA Global group is an independent and specialist provider of expert transfer pricing, tax valuation and customs services, headquartered in Amsterdam and with our own offices and coverage in over 25 countries around the world.

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