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What the Digitalization of Tax Authorities Means for Transfer Pricing

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With the push for global tax transparency moving full steam ahead, governments around the world are becoming increasingly savvy in their use of technology to increase compliance and drive revenue. At the same time, the digital nature of the global economy is prompting tax authorities to enact legislation that ensures digital business activities are fairly taxed. Together, these realities create quite a challenging environment for corporate tax professionals, particularly when it comes to transfer pricing.

In such a complex environment, it's critical for transfer pricing professionals to keep pace with technology, especially as governments use it to their own advantage. To understand this urgency, let's take a deeper look at what the digitalization of tax authorities means for transfer pricing and how technology can give tax departments an advantage, even amid a challenging landscape.

Understanding the Convergence of Tax Legislation and Digitalization

How Tax Authorities are Using Technology to Their Advantage

As tax legislation around the world continues to evolve, the technology used by tax authorities and governments is evolving as well, significantly changing the ways in which taxpayers must comply. From international digital reporting standards like SAF-T to real-time invoicing, governments are increasingly requiring digital data submissions to augment tax reporting.

This digitalization is giving taxing authorities an upper hand when it comes to analyzing data. For example, governments can use data analytics platforms to identify specific arrangements that pose a tax risk, scan Country-by-Country (CbC) reports for similar profiles or typologies, and select taxpayers exhibiting those profiles for further scrutiny.

Given these advantages, many countries are investing in advanced data analytics platforms to further increase compliance and reduce fraud. With tax authorities seeing significant ROI on these investments through increased tax revenue, this trend is certain to continue.

Adding to the global tax complexity is the fact that tax authorities are also increasingly looking to capitalize on the digital economy. To do so, they are enacting legislation related to "nexus" and "profit" with the goal of ensuring that digital business activities are taxed fairly. Examples of this push include a recent interim report from the OECD based on BEPS Action 1, the European Commission's recent proposals on taxation in the digital economy, and the recent decision on South Dakota v. Wayfair by the Supreme Court in the U.S.

The only constant in such a complex world is the fact that global tax legislation and digital initiatives driven by tax authorities will continue to accelerate. The only way for tax departments to keep pace is to take advantage of technology that adjusts to changes in legislation in real-time and offers modeling and scenario planning to help identify opportunities and avoid potential missteps.

Staying Ahead in a Complex Tax Landscape

How Technology Can Benefit Transfer Pricing Processes

When it comes to transfer pricing, most organizations are dealing with the same set of challenges: data scattered throughout systems and locations; manual processes that are not agile enough to adapt to shifting regulations; and of course, heightened scrutiny by tax authorities as they continue to use technology to their advantage.

However, by implementing a transfer pricing technology solution, tax departments can better manage the downstream effects of new tax legislation and understand the impact of that legislation on their compliance spend and processes.

Here's a closer look at the advantages that technology can provide tax departments as it relates to their transfer pricing processes.

1. **Use data analytics to review documentation from the perspective of the tax authority.**

   With technology, data and analytics are managed globally to produce the best insights for tax. This enables multinational enterprises to use the same powerful analytical tools as tax authorities to perform analysis on their own data to drive key business insights. Using technology to seamlessly shift between various documentation filing scenarios enables you to understand the impact on electronically filed documentation, including CbC reports, master file and local files.

   Consider this example: If you are a manufacturer in the UK, CbC reporting analytics can show you that there is a nearby procurement entity in Ireland, so your structure could pose an immediate BEPS risk to the UK tax authority. This insight enables you to stay ahead of potential inquires from local tax authorities.

2. **Model scenarios for the best possible outcome.**

   The ability to model scenarios in a centralized and seamless way helps to define transfer pricing policy and identifies the best methods of benchmarking in the face of change. With transfer pricing technology, you'll gain the ability to compile comparable company sets to approximate arm's length compensation in each region for all projected intercompany transactions, including tangible goods, loans, and royalties. You can also estimate tax liabilities, including new aspects of the Tax Cuts and Jobs Act (TCJA) including Global Intangible Low-Taxed Income (GILTI), and estimate your company's profitability.

3. **Convey a consistent transfer pricing story.**

   To tell a consistent transfer pricing story, look for a suite of software products that work together to help you automate and streamline your transfer pricing function. If you are a multinational corporation that needs help with your monitoring process, implement a solution that compiles all your documentation in one central location and gives you the ability to accurately and efficiently monitor your transfer pricing policy through an automated and repeatable process. With the onus of data collection being put on technology, your time is freed to focus on adding strategic value within your organization. Overall, a transfer pricing technology solution can help you lower compliance costs, mitigate tax risk, and achieve better results, even in the face of the digitalization of tax authorities.

Technology as a Foundation for Change

Staying one step ahead, in the years ahead

Clearly, there is a central theme that runs throughout the changing approach of tax authorities and related legislative initiatives: technology. As such, using a software solution to enhance your transfer pricing processes is no longer an option, but a necessity. With the same level of insight that tax authorities have, you can stay one step ahead even as legislation and digitalization continues to evolve. It's that agility and foresight that will empower your tax department now, and in the years ahead.

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