# Podcast transcript

## Transfer Pricing.

Podcast with Sean Foley, Principal of Global Transfer Pricing Services, KPMG in the US

*Musical intro*

**Announcer:**

Hello and welcome to the KPMG podcast series for tax leaders. For today's episode, I spoke to Sean Foley. Sean is Principal of Global Transfer Pricing Services at KPMG in the US and works with major organizations and multinational corporations to analyze their intercompany transactions and develop practical transfer pricing strategies.

Sean, thanks for taking the time to join us today.

**Sean:**

Good to be here.

**Announcer:**

Sean in this podcast series we are exploring the themes of geopolitics, digitalization and changing business models.

### Today I wanted to use our time together to talk about transfer pricing and I want to start by asking how the use of data and analytics is impacting audits and changing the tax landscape?

**Sean:**

There are several ways in which we see the impact. One is that governments are using analytics to select companies for audit, thinking about data, running it through algorithms to figure out which companies are perhaps the highest risk from their point of view. We're seeing a number of governments that are doing that in more and more sophisticated ways. But another way in which it is also rolling out is that the audit process itself, the analytics around, and particularly information on the Internet, such as LinkedIn and other similar kinds of information, is being pulled in more and more into audits themselves. And so we find that it's not just the audit selection but the audit process is being affected.

Beyond that, there are important trends that are the information exchange itself. So the amount of information that's available, not only are the analytics increasing, but the information flows between governments are a very important part of the developments. One of these would be the Country-by-Country reports in which governments around the world, for the very first time, have a very clear picture of the tax footprint of each of the major multinationals that may operate in their jurisdiction. So this additional information that they're receiving from other governments is also a very important way in which analytics and the information associated with it is changing the tax landscape.

**Announcer:**

### Sean you mentioned Country-by-Country reporting. Are you aware of this being used to trigger audits?

**Sean:**

Yes, this information was first exchanged for the tax year 2016, and so companies were filing their returns in late 2017 for the very first time, and then governments began to exchange those reports in 2018. So for a calendar year taxpayer, the very first reports would have been exchanged in June of 2018. So now we're here in 2019, nine months, ten months later, and actually, for the very first time in the last couple of months, we've seen a couple of audits that were triggered by these CbyC reports, and this is important, because we've been expecting this to be happening, but we hadn't seen it actually happening on the ground.

And now, as I said, we have two examples, one in Austria where a company that had a, what we call a Swiss principal structure, in which the Swiss parent company was responsible for managing the company's overall business, and therefore, from the point of view of the company, deserve the lion's share of the profit. The Austrian tax authority challenged that. They were looking at some cross-border payments between Switzerland and Austria and saying, no, the Austrian subsidiary ought to be getting a much higher amount of return, and this was all coming out of a CbyC report, and we know that because the Austrian tax authority, when they sought to audit and then adjust the returns in Austria, they looked at an important factor that's in the CbyC report, which is head count. One of the things that's reported on this report is the amount of personnel that are in each country around the world, and the Austrian government said, we think that we ought to have a profit split here, and we ought to be looking at the relative head count in Austria vs. Switzerland vs. other countries around the world, and Austria ought to be getting a much larger share, and in fact, they ought to get a proportion of the overall profits related to the amount of head count in Austria, and Austria had a very significant amount of head count and therefore was going to vastly increase the amount of income in-country. Now this use of the CbyC report is actually not sanctioned by the OECD. So one of the things that my colleagues working on this audit to assist the company did, they pushed back very hard on the Austrian tax authority and said, no, this is not what you should be using this report for, and they also went into the substance of the relationship between Switzerland and Austria and said, no, we can demonstrate to you that there are senior people in Switzerland who really are controlling this company and deserve the return that's been assigned to them. So there was some back and forth, and then ultimately, this audit settled on an acceptable basis, but it did demonstrate what we've, in the corporate world, and in the advisory world, been fearful of, is that these CbyC reports, not only will they be triggering more audits, but they'll be triggering these profit splits as an approach, which can vastly change the results and are quite unexpected from a company's point of view as to the kind of tax they'd be paying.

**Announcer:**

**And Sean, to follow on from that how are you seeing changing business models affecting transfer pricing risk?**

**Sean:**

I think a really important development is virtual teams. So many companies these days are allowing the best people, they're looking for the best people, the best resources, and they're hiring them wherever they can find them, and they're not necessarily insisting that those resources, those senior people who are controlling marketing, controlling research and development, controlling other important aspects of the business, and these are, what we call in transfer pricing, DEMPE functions. These functions can be found across the globe in various different countries, and what that is highlighting is that as the rules have progressed over the last few years, and governments are challenging and saying, we really want to look for, where are the most senior people, because we think that's where the value should be.

If that value happens to just locate in Germany or in Belgium just because a person lives there, suddenly, your overall understanding of where your value chain and where you should be reporting income can be very much changed or distorted from, depending upon your point of view. But another aspect of this is that as people leave companies and then move, and you hire new people, suddenly, you had a senior person running research and development who happened to be sitting in Germany, and now that person left or moved, and now that person is now sitting in the UK, suddenly all the profit that was going to Germany, if that's the way you've been doing analysis, just moved to the UK because one person moved, and this is the kind of thing that we're seeing actually coming up on some audits, and is certainly creating a really difficult area for companies to try to understand just how very straightforward business decisions and HR decisions can suddenly be having these very dramatic swings in their tax profile.

**Announcer:**

**Okay Sean, so on the topic of change, what is your reaction to the OECD's release of the Digital Economy Action Plan on May 31?**

**Sean:**

Disappointment, and I guess, I say disappointment because we spent several years, between 2013 and 2015, companies came to the table with the OECD, and governments got together, the G20 thought hard about this, and ultimately adopted very dramatic changes. We've been talking about them, the Country-by-Country report, this DEMPE function analysis, the ways in which audits ought to be resolved cross-border, many, many important changes were finalized in December of 2015, and that is not so long ago, because it takes a number of years for governments to implement these changes into law and then companies to react, and they're having important effects on business, and business is, I think, following these new rules and working hard to try to respect the substance requirements, for example, that the governments have been asking for.

But rather than letting these rules sort of play out and settle down and let us all understand together whether or not we had solved many of these problems with this very important BEPS, the Base Erosion of Profit Shifting project that was completed, as I said, in 2015, the governments, the OECD, and the G20 have said, no, we're going to move forward on a very aggressive timeline, where now, between today here in 2019 and January of 2020, they're going to come up with a work plan that is actually going to come up with a basis of a consensus of how the digital economy is going to be taxed in a very different, and very potentially, now that we see the work plan, transformative and radical change to tax law, all happening on this extraordinarily accelerated time frame. But again, just returning to my earlier comment, we never even had an opportunity to see whether or not the problems were fixed under the other important changes and rules that were only just getting settled and affecting behavior. So I guess, it seems that this is going to happen, it doesn't seem like this is a train that can be stopped, but that said, my short answer is disappointed.

**Announcer:**

**Sean we have covered a lot today and clearly a lot is changing in the world of transfer pricing but if you could leave our listeners with one piece of advice what would it be?**

**Sean:**

I think companies really need to do a hard look at their supply chain, at their transfer pricing methods, at the way in which business and tax are intersecting, because there's been so much change in the rules, in the way governments are enforcing rules, that it really behooves, I think, the tax departments of major companies, of major multinationals, to take a hard look and make sure that their current approach to their tax positions is consistent with the new rules.

**Announcer:**

Sean, it’s been a real pleasure speaking with you today. Thank you.

**Sean:**

My pleasure, thanks for having me.

**Announcer:**

Join us again next time and please let us know if you have any suggestions or ideas for future topics that you would be interested to hear about in this series of podcasts. You can email us at tax@kpmg.com. Thanks for listening!

*Musical exit*