



# TRANSFER PRICING



REPORT

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## Rampant Globalisation—Yet a Dearth Of Professionals to Lead the Way in Transfer Pricing?

Readers are encouraged to respond to this Perspective article and to contribute their own views to continue this discourse on transfer pricing policy issues.

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The unprecedented pace of globalisation, particularly since China joined the World Trade Organization at the end of 2001, has resulted in an equally unforeseen growth of intercompany transactions and transfer pricing valuation issues. Many national governmental authorities, unfortunately, have responded to the new opportunities and related resource requirements by impatiently claiming their sovereign right to issue decree laws and regulations unilaterally rather

than in alignment with international guidelines.<sup>1</sup>

Moreover, different parts of the same government are pursuing contradicting policies affecting transfer prices, such as the control of market prices, customs duties, value added tax and in some industries, such as biotech/pharmaceuticals, even regulated levels of gross income. Even greater uncertainties arise for multinational enterprises because nation states are not prepared to resolve transfer pricing disputes among themselves within reasonable time limits.

Multinational enterprises' concerns about their risk exposure from the growing diversity of unilaterally enforced transfer pricing rules and regulations with often

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<sup>1</sup> For instance, the German government, as a signatory state of the European Union as well as the Organization for Economic Cooperation and Development, had the chance to inspire opinion leadership there for a unified structure and development of transfer pricing policies. Instead, concurrent to participating in the European Union Joint Transfer Pricing Forum's move to present acceptable policies for application throughout the European Union, the government pushed through the German Parliament March 14, 2007, extensive, non-aligned regulations with decree law status (15 *Transfer Pricing Report* 841, 3/21/07).

onerous and divergent documentation requirements<sup>2</sup> have been well surveyed and documented.<sup>3</sup> Managing these risks has become an issue of corporate governance with reporting obligations to the executive board's audit committee as well as to internal and external auditors.

It is astounding, therefore, that—irrespective of such a rise in complexity and the resultant risks for corporations and governments alike—globally there is a dearth of professionals specifically enabled to manage the broad range of transfer pricing issues at every level of

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<sup>2</sup> “The explosion [of required transfer pricing reports] is just unfathomable,” according to General Electric Co. Senior International Tax Counsel Peter Barnes (15 *Transfer Pricing Report* 851 4/4/07).

<sup>3</sup> See, for instance, Deloitte: “Strategy Matrix for Global Transfer Pricing, 2007”; Ernst & Young, 2005-2006 Global Transfer Pricing Surveys; PricewaterhouseCoopers, International Transfer Pricing 2006. See also results of the KPMG survey (16 *Transfer Pricing Report* 220, 7/26/07).

the affected public and private organizations. This article is an attempt to initiate a public debate about transfer pricing policy issues, in particular a renewed political leadership drive for the global recognition of a principles-based approach in transfer pricing similar to the one which has brought U.S. and European opinion leaders to congregate on the need for a globally unified accounting language.<sup>4</sup> Also, concerted efforts are suggested for the establishment of an authoritative guidance to enhance the training and the development of a multidisciplinary expertise of future transfer pricing professionals.

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<sup>4</sup> See Commission of the European Communities, *First Report...on convergence between International Financial Report Standards (IFRS) and third country national Generally Accepted Accounting Principles (GAAPs)*, Brussels, July 7, 2007; “IFRS: The Quest for a Global Language,” [www.kpmg.co.uk](http://www.kpmg.co.uk), and Bruce, Robert, “Accountants of the world uniting in IFRS revolution,” *Financial Times*, June 21, 2007.

## Increased Intercompany Trade Globally

Despite recent international trade negotiation breakdowns and slim hopes for reviving the Doha Round,<sup>5</sup> globalisation continues to show its positive<sup>6</sup> effects everywhere. This is particularly so in Asia, Europe, and the Americas but also within the recently established cross-continent alliances such as BRIC<sup>7</sup>—Brazil, Russia, India, and China. While some of these nation states were either sufficiently opinionated to enforce transfer pricing regulations divergent from international guidelines (Brazil), others—on the basis of realising more and more their own export chances (India and China)—are now addressing the need for reciprocity in bilateral or multilateral trade relations.<sup>8</sup>

Nation states are slowly realising that it may not be in their best interest to maintain direct or indirect barriers to international trade nor to create new ones, such as peculiar transfer pricing regulations.<sup>9</sup> Governments are moved to develop acceptable structures—also in consideration of transfer pricing—to take advantage of new opportunities and thereby gain a greater share of international trade.

Consequently, and also in view of heavily expanding trade across national borders, the need for specially skilled transfer pricing professionals is higher than it has ever been. But where is the transfer pricing expertise, so dearly needed, to come from?

## Trade Politics

The United States faced this question already more than a decade ago. Focusing on Japanese car and electronics manufacturers, presidential candidate Bill Clinton claimed in 1992 that foreign companies were overcharging their U.S. subsidiaries and thereby underpay-

ing the Internal Revenue Service by some \$45 billion over four years.<sup>10</sup> Both tongue-in-cheek and seriously, Clinton declared that he would not want to suggest to his fellow Americans which car or television to buy. However, he surely wanted to mandate that foreign manufacturers show appropriate profits in the United States and pay just taxes on those profits.

Fifteen years later, in the first quarter of 2007, Toyota unseated General Motors as the world's largest carmaker and Michigan's state senator Debbie Stabenow is advocating lawmakers to vote on a "Japan Currency Manipulation Act" because Japan is supposedly enforcing a "substantially undervalued" Yen.<sup>11</sup>

Concurrently, a similar claim of an uncompetitively low Chinese Yuan exchange rate against the U.S. dollar has given rise to a number of new bills introduced in the U.S. Congress by both parties.<sup>12</sup> Official interventions by the U.S. government against China included several visits to China by U.S. Treasury Secretary Henry Paulson. China's first-quarter 2007 rise in foreign exchange reserves of \$135.7bn to \$1,202bn<sup>13</sup> cannot, of course, be considered solely the result of China's vastly increased exports, but surely is a significant portion thereof.

The Chinese government has recognized the impact of trade relations on transfer pricing. China has sought to increase the number and the competence of tax auditors at all levels of local, regional, and federal governments to comprehend and to successfully argue with affiliates of multinational corporations about their intercompany prices.<sup>14</sup>

<sup>10</sup> Malkin, Lawrence, "Putting Tax Squeeze on Foreigners: Easy to Promise, Hard to Do," *International Herald Tribune*, October 31, 1992.

<sup>11</sup> Caldwell, Christopher, "America's new angst over Japan," *Financial Times*, April 28, 2007.

<sup>12</sup> See "Getting tough on the Chinese—again," *Financial Times*, June 18, 2007. A variety of new legislation aimed at forcing China to revalue the renminbi are before the U.S. Congress, as is a bipartisan initiative (supported by Democratic presidential candidates Hillary Clinton and Barack Obama) of Democratic senators Max Baucus, Charles Schumer, and Republican senators Charles Grassley, Lindsay Graham. See "We must act when currencies become misaligned," *Financial Times* July 6, 2007.

<sup>13</sup> McGregor, Richard, "China moves to explain \$136bn forex surge," *Financial Times*, April 16, 2007. Not merely the total value but the number and growth of transactions need to be considered.

<sup>14</sup> "Over the recent years, the SAT has focused on the establishment of a specialized transfer pricing investigation and adjustment team. It currently has more than 1,000 tax officials nationwide specializing in transfer pricing. Many of the officials have overseas training experience, but little information publicly exists about whether they are trained transfer pricing examiners or economists" (15 *Transfer Pricing Report* S-9, 1/24/07).

The Chinese authorities are utilizing all available international resources to educate their inspectors in transfer pricing—using resources of the OECD outreach programme and bilateral support programmes as well as training provided by corporate executives.

See also "Transfer Pricing Enforcement Increasing Worldwide Even as Countries' Approaches Diverge, Survey Says" (15 *Transfer Pricing Report* 375, 9/27/06); "Japan Increases Examiners by 18 Percent in FY07 to Assess Cross Border Transactions" (16 *Transfer Pricing Report* 90, 5/30/07); and Li, Jian and Paisey, Alan, *Transfer Pricing Audits in China*, Palgrave Macmillan, New York 2007, p. 108.

<sup>5</sup> The Doha Development Round of the World Trade Organization negotiations aims to lower trade barriers around the world, permitting free trade between countries of varying prosperity. Since 2006, talks have stalled over a divide between the developed nations led by the European Union, the United States, and Japan and the major developing countries, led and represented mainly by India, Brazil, China, and South Africa.

<sup>6</sup> See, for instance, *Financial Times*' chief economic editor Martin Wolf's book, *Why Globalisation Works*, Yale University Press, New Haven and London 2004. Wolf arrives at that positive conclusion by arguing with the reasoning of the critics of globalization on half of the 320 pages.

<sup>7</sup> The term was coined 2003 ("Dreaming with BRICs: The Path to 2050"), by Jim O'Neill, global economist at Goldman Sachs, who argues that the economic potential of Brazil, Russia, India, and China is such that they may become among the four most dominant economies by 2050.

<sup>8</sup> This trend is followed also among major trading partners of the developed world: In view of about 40 percent of worldwide trade being conducted between the European Union and the United States a "Transatlantic Economic Council" at ministerial level has been set up in April 2007 by the European Commission and the United States to improve trade relations by reducing the non-tariff barriers to trade and agreeing to (also accounting) standards acceptable to both economic regions.

<sup>9</sup> Apart from Brazil, where the *Receita Federal* stubbornly insists that "double taxation is part of doing business in Brazil." This position, among others, led the German government after multiple negotiations with three successive Brazilian governments over seven years to rescind the double taxation agreement with Brazil in 2005 (13 *Transfer Pricing Report* 1230, 4/27/05).

Political claims for the need to tighten transfer pricing 15 years ago are similar to these current trade-related reverberations. During the Clinton administration transfer pricing policy considerations became elevated as a new paradigm which was quickly copied by some governments around the world. However, it also led to an impressive level of diplomacy among OECD member states which in 1995, fortunately,<sup>15</sup> allowed it to publish the *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. It is this political will that was demonstrated in 1995 that is needed to gain strength again now.

### Nationalist Tendencies Feared

It is feared, however, that the now again growing sensitivity over the size and domestic political consequences of external trade imbalances and conflicting views about equitable transfer pricing methods could further strengthen the already apparent national(istic) impatience of signatory states as well as non-member OECD states. Embarking on shortsighted unilateral transfer pricing regulations would create additional risks for multinational corporations and governmental authorities alike. Global companies would be forced to devote additional costly resources and in all probability also to account for and eventually to bear the consequences of uncertain tax positions. Governments on the other hand would become more and more entangled in long-term competent authority procedures with uncertain returns.

It appears pivotal, therefore, that existing centres of private transfer pricing excellence must be prepared to overcome their (understandable) vested interests and work with the OECD and others to strengthen the global leadership in transfer pricing and at the same time to limit their private customers' long-term risk exposure.

The 2006 settlement of the U.S. Tax Court case involving GlaxoSmithKline Holdings (Americas) Inc. (which some practitioners said yielded the U.S. government less than the "unwritten rule" of 20 percent of the disputed assessment to justify such an extended transfer pricing dispute)<sup>16</sup> is the most recent and largest case to illustrate the hitherto unimaginable risks for national governments and their corporate targets emanating from transfer pricing.<sup>17</sup> Irrespective of this settlement in the United States, related transfer pricing claims dis-

puted by the company are still in the process of litigation in Canada, Japan, and England.<sup>18</sup>

Transfer pricing expertise is most needed by:

- multinational enterprises operating globally—i.e., their executive boards, audit committees, general managers, and their corporate and national staff of legal, tax, finance, customs, logistics, and controlling professionals;
- competent authorities—e.g., regulatory pricing, finance, trade, customs, and tax authorities;
- consulting firms advising or auditing multinational enterprises, and nation states' authorities;
- supranational authorities such as the OECD, the European Union or the United Nations;
- multilateral or regional interest groups, such as those involved in NAFTA, ASEAN, APEC, BRIC, Mercosul, or PATA/Leeds Castle Group<sup>19</sup>
- national and supranational trade representative organizations such as the Business and Industry Advisory Committee (BIAC) to the OECD and the United States Council for International Business (USCIB); and
- courts or arbitration panels called upon to decide disputed transfer pricing cases.

### Multidisciplinary Approach Necessary

Arguably, transfer pricing is not purely a technical matter<sup>20</sup> to be singularly left with any one of the professionals currently involved—tax lawyers, certified public accountants, independent private, or nation states' auditors, corporate tax managers, economists, controllers, financial analysts, corporate transfer pricing experts or general managers. Rather, the complex nature of resolving transfer pricing problems should be dealt with in multidisciplinary groups of experts that bring together the long-term perspective of national and supranational authorities and their respective international trade representative strategy groups.

The business side also requires multidisciplinary communications among responsible general managers together with their experts representing corporate transfer pricing, accounting, tax, finance, and customs both within the corporate group, and also their various national and supranational trade representations, as well as in their negotiations with respective local, regional, and national governmental authorities.

To explore the potential of dispute resolutions and to mastermind the eventualities of the processes and risks associated with a decision to litigate necessitates an even greater preparedness for multidisciplinary communications. For these communications and resulting decisions to become effective and sustainable in the long run, a non-biased exchange of data, analysis presentation, and judgment based on respecting and un-

<sup>15</sup> To cite just one prominent participant and commentator: "The preservation of a strong international consensus concerning the fundamental principles of transfer pricing is the only sure means of preventing double taxation and consequent disruption of international trade. Thus, the reestablishment of such a consensus through the publication [of the guidelines] . . . is a major achievement for the OECD and its member countries. While there will no doubt always be transfer pricing issues that are difficult to resolve, the chances for doing so in a principled and efficient manner are vastly improved by the new guidelines." Culbertson, Robert, "A Rose By Any Other Name: Smelling The Flowers At The OECD's (Last) Resort" (68 *Tax Notes* 1335, 9/11/95).

<sup>16</sup> See, for instance, Levey, Marc, "Marketing Intangibles, Glaxo Case Highlights Marketing Intangibles, Lack of U.S. Jurisprudence, Practitioners Say" (15 *Transfer Pricing Report* 520, 11/22/06).

<sup>17</sup> GlaxoSmithKline resolved the dispute with the IRS Sept. 11, 2006, covering 16 open years by paying \$3.3 billion. See the group's Annual Report 2006, p. 101.

<sup>18</sup> GlaxoSmithKline Annual Report 2006, pp. 47 and 101.

<sup>19</sup> NAFTA: North Atlantic Free Trade Agreement nations; ASEAN: Association of Southeast Asian Nations; APEC: Asia-Pacific Economic Co-operation; BRIC: Brazil, Russia, India, China; Mercosul: the Mercado Comum do Cone Sul (Argentina, Brazil, Paraguay, and Venezuela); PATA/Leeds Castle Group, (superseding PATA original members Australia, Japan, Canada, and the United States and now China, India, France, Germany, South Korea, and the United Kingdom).

<sup>20</sup> There are some who insist on transfer pricing being an art; See, for instance, John A. Menge, "The Backward Art of Interdivisional Transfer Pricing," *Journal of Industrial Economics*, Vol. 9, No. 3 (Jul., 1961), pp. 215-232.

derstanding the other professionals' reasoning is essential. All too often heavy-handed dominant postures of representatives from one profession over those of another can create more problems than solutions.<sup>21</sup>

## Training Today

### Practical On-the-Job Training

Transfer pricing training today basically takes place on the job at:

- multinational enterprises operating on a global scale<sup>22</sup>;
- national governmental authorities;
- national and international trade representative bodies;
- Big Four accounting and consulting firms—Deloitte Touche Tomatsu, Ernst & Young, KPMG, and PricewaterhouseCoopers;
- (tax) law firms such as Baker & McKenzie, McKee Nelson LLP, and Mayer, Brown, Rowe & Maw LLP;
- economic consulting firms, such as Ballentine Barbera, Analysis Group, and NERA; and
- specialist transfer pricing consulting groups such as Transfer Pricing Associates.

Transfer pricing training also takes place through peer exchange of information and training at:

- OECD organized conferences, as well as outreach and peer review programmes and cooperative programmes with the World Customs Organization (WCO),<sup>23</sup>
- the European Union's Joint Transfer Pricing Forum and the Community Action Programme "Fiscalis 2003—2007" of national tax administrators;<sup>24</sup>
- national competent authorities' internal and external training programmes;
- Big Four as well as other consulting firms' customer-specific in-house training programmes;

<sup>21</sup> Too often tacit or even overt jibes occur out of ignorance, sniping for instance at accountants as "bean counter," economists as "equivocal oxymorons" generating models with any solution at will or lawyers hiding behind rules and regulations and threatening with sanctions without taking responsibility in decision making, etc.

<sup>22</sup> Against formidable competition of some of the Big Four consulting firms, the author enhanced the capacity of his corporate transfer pricing department with two of the few doctoral students who focused their academic training on transfer pricing:

Monica Boos, a student of Heinz Rehkugler at the Albert-Ludwigs-University of Freiburg in Germany, published her thesis, "International Transfer Pricing: The Valuation of Intangible Assets," in Kluwer Law International, The Hague 2003. She now has general management responsibilities in one of the core business divisions of the German Bayer Schering Pharma AG.

Dan Bauer, a student of Hans-Jochen Kleineidam at the Helmut Schmidt-University Hamburg in Germany, published his thesis, "Neuausrichtung der internationalen Einkunftsabgrenzung im Steuerrecht," Erich Schmidt Verlag, Berlin 2004. He now heads corporate transfer pricing of the German Südzucker AG.

<sup>23</sup> The WCO and OECD in May 2007 held their second joint conference to address the almost universally unresolved issues surrounding the alignment of valuation for customs and transfer pricing purposes (16 *Transfer Pricing Report* 115, 6/13/07).

<sup>24</sup> See [http://ec.europa.eu/taxation\\_customs/taxation/tax\\_cooperation/fiscalis\\_programme/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/tax_cooperation/fiscalis_programme/index_en.htm)

■ the International Bureau of Fiscal Documentation's International Transfer Pricing Journal and International Tax Academy;

■ BNA Tax Management's *Transfer Pricing Report* and *Tax Planning International Transfer Pricing*;

■ the European American Tax Institute's regular transfer pricing seminars, regional roundtables, and conferences;

■ the International Tax Institute and the Council for International Tax Education (CITE); and

■ national and international conferences, such as the annual global transfer pricing forum organized by Eurromoney's *International Tax Review*.

### Academic Training

In academia, currently only a few universities offer courses or programmes dedicated to transfer pricing and most of the (very recently introduced) courses are aimed solely at broadening the perspective of future tax lawyers.<sup>25</sup>

In the United States, for instance, John Magee from McKee Nelson LLP and Steven Wrappe, formerly with Deloitte Tax LLP and now with Mayer, Brown, Rowe & Maw LLP, have been teaching "Transfer Pricing: Theory vs. Practice"<sup>26</sup> since 2003 at Georgetown University Law Center in Washington, D.C. David Rosenbloom teaches a transfer pricing course geared to law students at New York University as well as "Taxation of International Business Transactions," which employs an interactive mode among students of different nations in groups of three who are coached additionally by a practicing lawyer based on practical case studies. Harvard's International Tax Program refers to a course "Taxation of International Transactions" in 2008.

Early in 2007, Lorraine Eden at Texas A&M University took the initiative to lecture a demanding transfer pricing programme, "International Transfer Pricing," for masters students with management and/or economics backgrounds.<sup>27</sup> In Europe, and similarly so in Australia, China, Japan, and India, the first tier universities and their business schools are not yet offering special transfer pricing courses. Transfer pricing is addressed only in the context of courses on international taxation.

### Government Training

A few governments are leading the development in transfer pricing together with and for their own civil servants as well as for others through their bilateral relations with other nations. Eased by a common lan-

<sup>25</sup> A few courses are now offered at Chicago-Kent Law School, University of Miami Law School, University of Florida Law School, University of Washington Law School, Boston University Law School, Golden Gate University Law School, Northwestern University Law School and New York Law School.

<sup>26</sup> Using the textbook Levey, Marc/Wrappe, Steven, "Transfer Pricing Rules, Compliance and Controversy," CCH, Chicago, 2001, and Levey, Marc, Wrappe, Steven/Chung, Kervin, "Transfer Pricing Rules and Compliance Handbook," CCH, Chicago 2006.

<sup>27</sup> For further information see <http://www.voxprof.com/eden/eden-transfer-pricing.html> or contact Professor Eden at <leden@tamu.edu>. Professor Eden is the author of the standard transfer pricing textbook *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America*, University of Toronto Press, Toronto 1998.

guage, which appears particularly suitable for describing the inherently complex considerations of transfer pricing, these are the U.K. Her Majesty's Revenue & Customs (HMRC), the U.S. Internal Revenue Service (IRS), and the Australian Taxation Office (ATO). Supranational organizations such as the OECD and the European Union are in some way beneficiaries of these national development efforts as national representatives are seconded to them or are serving at the regularly convening committee meetings of both of their transfer pricing competence centres.

### International Conferences, In-House Seminars

The Big Four accounting firms, some economic consulting firms such as The Ballentine Barbera Group,<sup>28</sup> Analysis Group, or NERA and major law firms such as Baker & McKenzie have identified transfer pricing as a "product" to be developed and offered to their customers operating on a worldwide scale. They have been and are devoting significant resources to programme development and training internally—both in advisory as well as auditing parts of the firms—and through sponsoring dedicated conferences.<sup>29</sup> Additionally, in-house seminars and training courses are conducted to address the specific needs of multinational corporations and governmental authorities.

### Myriad of Issues

One issue that accounting firms struggle with are conflicts of interest generated by serving their customers both as auditors as well as consultants. To overcome any discrediting presumption, a "Chinese Wall" is pledged to exist between auditing and consulting and some firms have created separate firms for either service. This, however, still does not fully eliminate conflict of interest issues. As consultants advising national and supranational regulatory authorities as well as multinational enterprises, they must have reason to be concerned about the ramifications of their policy proposals to the regulatory authorities which then become governed at the expense of their business customers.

Multinational enterprises are used to being targets of criticism. When it comes to distributing earned income, though, they not only have to deal externally with governments, NGOs, etc. but also internally with contentious negotiations internally among their general managers.<sup>30</sup> However, being squeezed between two or more disagreeing authorities and having unilateral assessments in one state disregarded in the other(s) irrespective of existing double taxation treaties, stretches corporate executives' willingness to accept risks beyond those to which they are accustomed. This is when they, together with their executive boards, understand the need to seek political resolutions to what originally has

<sup>28</sup> Now a member of the CRA International group of consulting companies.

<sup>29</sup> Deloitte spearheaded the first global transfer pricing conferences a decade ago. The next high-level annual meeting of transfer pricing professionals will be sponsored by Baker & McKenzie Sept. 25-26 in Berlin, Germany.

<sup>30</sup> Representative interviews among corporate executives responsible for transfer pricing policy and governance and their colleagues responsible for the operating business would reveal that pricing negotiations among related parties are often much fiercer than those with third parties.

basically been an issue of economics. Unfortunately, however, such initiatives too often are made in pursuit of that one case under audit rather than it taken as an example to provide support for developing principles-based transfer pricing policies on the national and, ideally, the supranational level of the OECD and beyond.

Dealing with the complexity of transfer pricing has been a critical issue from the very beginning and it is even more so today. It is increasingly fact intensive for many reasons, including recent regulatory actions such as the Sarbanes-Oxley legislation, Financial Accounting Standards Board Interpretation No. 48,<sup>31</sup> and the ongoing accounting controversy of the U.S. versus the International Financial Reporting System.<sup>32</sup>

Not least among further pressures is the unrelenting issuance of unilateral transfer pricing laws and regulations that diverge from the OECD guidelines. These guidelines at the time of their issuance were meant to be the standard and authoritative reference on transfer pricing issues globally.

It is, therefore, unfortunate to realize that even OECD member states argue to be pressured by the realities of globalization to newly adopt transfer pricing regulations unilaterally.<sup>33</sup>

### Skill Sets Necessary for the Future

The ability to propose an acceptable transfer pricing policy as the basis to politically govern, manage, and if necessary to defend and resolve transfer pricing issues with national interests and global concerns affected requires open minds. Both in theory and in practice well trained professionals who are prepared to think and to work in an interdisciplinary environment are therefore of the essence. Such professionals will be ready to find fair solutions while considering intricate details of particular cases as well as to present acceptable options for some of the broader political concerns.

For instance, data within the public domain have varying degrees of accessibility, quality, detail, and therefore comparability. It is, therefore, astonishing to observe a reliance on numbers taken at face value by transfer pricing practitioners, who commonly are assessing arm's-length prices upon working capital adjustments only.

There has been and still is today an apparent dichotomy between the U.S. rules-based approach and the EU's more principles-based approach to transfer

<sup>31</sup> FIN 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109, clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement of a tax position taken or expected to be taken in a tax return. This interpretation, which also provides guidance on derecognition, classification, interest, and penalties, accounting in interim periods, disclosure, and transition, is effective for fiscal years beginning after December 15, 2006.

<sup>32</sup> IFRS (International Financial Reporting Standards) has evolved from the former IAS (International Accounting Standards) and has become the mandatory accounting standard in Europe 2005.

<sup>33</sup> For instance, on March 14, 2007, the German Parliament passed a new Business Restructuring Law with measures to tax the income from assets moved outside Germany.

pricing resolutions.<sup>34</sup> The U.S. approach is considered by some<sup>35</sup> an essential safety net in the litigious environment of the United States.

Additionally, because of still non-aligned accounting principles, corporate annual reports contain, for instance, as many as 13 pages<sup>36</sup> of reconciliation between U.S. GAAP and IFRS. The interest in, and the need for, supranational comparative analyses of “like with like”—without any complex reconciliation or adjustment efforts based on the insufficient data available in the public domain—suggest that equitable valuation practices cannot remain national. Therefore, great efforts have been devoted to the potential for convergence especially of the U.S. generally accepted accounting principles and the newly developed IFRS, which has been enforced in the European Union since 2005. However, particularly on the issues surrounding the options for valuation of intellectual property rights,<sup>37</sup> it appears unlikely that a satisfactory solution will be found soon.

Various governmental agencies—such as those in control of market prices, transfer prices, customs duty, or value added tax (VAT)—each are pursuing their respective and particular goals while ignoring data-interdependence for achieving acceptable results for the nation state(s) and the affected corporation(s), for example:

- Corporations providing year-end compensatory payment to reach a defensible margin range for income tax purposes are not granted equivalent duty relief.

- Corporations using a comparable data set, including those data that later become burdened by assessments during audits, are not granted ex-post analysis together with equivalent relief.

- The commensurate-with-income standard is applied by some tax authorities<sup>38</sup> to claim a higher share of income when “super-profits” occur. They are, how-

ever, not prepared to going back when comparable data of significance for the outcome became used, such as of the magnitude of GlaxoSmithKline, which later were (successfully) contested.

The interdependence of transfer pricing and customs duty has meanwhile at least been recognized by some governments.<sup>39</sup> However, although respective intricacies have been explored at joint meetings of the OECD and the WCO,<sup>40</sup> a solution appears to be elusive for many reasons.<sup>41</sup> Also, economically feasible solutions to the issues surrounding ex-ante and ex-post comparability of transfer pricing remains a far reach. Much greater than the currently available transparency of data is required for satisfactory data analyses to be made possible.<sup>42</sup> Further, the reduced availability of comparable data in the public domain as a result of the unprecedented activity and success of private equity acquisitions and particularly the increasing difficulty of providing ex-post factual evidence for rules-compliant ex-ante decision making suggest the need to consider alternatives to hitherto accepted transfer pricing solutions.<sup>43</sup>

The few issues highlighted above are examples only to illustrate the breadth of academic training and the politically sensitive mindset needed by future transfer pricing professionals. On the basis of undergraduate studies towards obtaining at least one of the related professional degrees, primarily analytic, numerate, and communication—and therewith negotiation—skills are necessary and vital for future transfer pricing professionals to become effective. Their determination to comprehend the concepts of the other professions and to understand and respect the differing interests of nation states as much as those of the multinational corporations operating therein would greatly enhance their ability to contribute to the professions’ advancement and recognition.

## Formal Training, Certification

Lawyers and accountants have, for centuries, been recognised to practice only after formal training evidenced by an authoritative university degree. Certified public accountants as auditors or consultants, professionals of finance and tax, as well as economists (whether being employed as civil servants of local, regional or federal authorities or in private firms) are engaged on the basis of a authoritatively structured and certified training. Transfer pricing, however, does not have any such tradition, nor is this a discipline as uniquely identifiable as law, accounting, finance, tax, or economics. So far, transfer pricing is practised by anyone who happens to become in charge or has inherited

<sup>34</sup> Compare the fundamental observations of James Mogle, “Mogle Chronicles Transfer Pricing’s Evolution in 20 Year Career” (15 *Transfer Pricing Report* 50, 5/24/06).

<sup>35</sup> “A rules-based system, whether for accounting or regulation, has a safe harbour effect,” See Wallison, Peter, “America will prefer to rely on rules, not principles,” *Financial Times*, July 6, 2007.

<sup>36</sup> See, for instance, GlaxoSmithKline, Annual Report 2006, pp. 139-152.

<sup>37</sup> As IFRS requires capitalisation of acquired intellectual property there are moves by some to also declare in-house development cost as assets on the balance sheet. The particularly high risk experienced by biotechnology and pharmaceutical corporations in the process of developing innovative medicines mandates disallowance of any such intentions. The temptation for CEOs and/or CFOs in financially difficult times to meet the quarterly expectations of the financial analysts for having the valuation of development projects more favourably “reviewed” may be for some CEOs or CFOs just too great. This door should, therefore, be closed from the outset.

<sup>38</sup> The U.S. and the German authorities each have issued new administrative guidance for applying the commensurate-with-income standard (CWI) with particular emphasis on transactions concerning controlled intangible transfers. The IRS March 15 issued its new interpretation, “Taxpayer Use of Section 482 and the Commensurate With Income Standard,” and the German Parliament March 14 approved the new Business Restructuring Law which introduces, amongst others, the CWI concept in the context of the relocation of functions and therewith transfers of (intangible) assets. See 15 *Transfer Pricing Report* 859, 4/4/07; 16 *Transfer Pricing Report* 221, 7/26/07; and Heinz-Klaus Kroppen, Stephan Rasch, and Axel Ei-

gelshoven, “Germany’s Draft Law on Business Restructurings,” 15 *Transfer Pricing Report* 841, 3/21/07.

<sup>39</sup> Most prominently the U.K. government by enhancing the responsibility of the former Internal Revenue to become in 2005 “Her Majesty’s Revenue & Customs (HMRC).”

<sup>40</sup> See footnote 22.

<sup>41</sup> “Customs, Transfer Pricing Convergence Remains Desired, But Practitioners Say Achieving Objective Remains Elusive,” 16 *Transfer Pricing Report* 115, 6/13/07.

<sup>42</sup> Further, constraints on time and money lead to opportunistic “quick and dirty” reports.

<sup>43</sup> See, for instance, Hubert Hamaekers, “Arm’s Length—How Long?” *International Transfer Pricing Journal*, March-April 2001.

a trade-related pricing or policy problem in public or private office at any level of training or experience.

However, managing the complexity of transfer pricing issues requires a degree of sophistication that should not be left to haphazard developments. Examples including the “increasingly blurred line between prospective regulatory developments and retrospective audit activity,”<sup>44</sup> the growing divergence in the approach to transfer pricing,<sup>45</sup> and additionally the risks associated with the management and governance of and the (too often stalled) arbitration procedures between competent authorities are indicative of the need for a new political leadership initiative.

As other professions are having similar concerns, the assessment of training needs for Chartered Financial Analysts may become a useful reference.<sup>46</sup>

Multinational enterprises and governments would both benefit if they could rely on graduates of transfer pricing programmes of internationally recognized universities. It is in these academic institutions where students are not merely acquiring technical skills but are exposed to processes of multi-disciplinary learning, thinking, and problem solving.

## Risk Assessment

Transfer pricing professionalism for risk assessment matters as much for business as it does for governments—especially to avoid undue resource utilization.<sup>47</sup> Particularly on the business side, establishing a certifiable corporate risk management programme for transfer pricing<sup>48</sup> would alleviate corporate governance concerns of the executive board, the board’s audit committee, the internal as well as external auditors, and the corporation’s tax department.

<sup>44</sup> “U.S. Risks ‘Overreaching’ in Enforcement of Transfer Pricing, Attorney Tells Forum” (16 *Transfer Pricing Report* 78, 5/30/07).

<sup>45</sup> “Transfer Pricing Enforcement Increasing Worldwide Even as Countries’ Approaches Diverge, Survey Says” (15 *Transfer Pricing Report* 375, 9/27/06).

<sup>46</sup> See the U.K.’s Financial Services Sector Skills Council: “Financial Training,” *Financial Times*, Special Report, June 18, 2007.

<sup>47</sup> The U.K. Inland Revenue for years and now the HMRC requires auditors to make risk assessments before moving to litigate. See Inland Revenue Tax Bulletin Issue 60, “HMRC approach to compliance risk management for large business” hmrc.gov.uk. HMRC is “promoting a collaborative debate with our customers” using a risk review template. See “HMRC Approach to Transfer Pricing for Large Business, Consultation Document, June 20, 2007, p. 9. The Canada Revenue Agency (CRA) on the other hand has become known as one of the most aggressive enforcement agencies by the use of court resources so far unheard of, seemingly irrespective of the potential returns. In what appeared to be a “fishing expedition” corporations around the world were served with depositions at their national courts to produce confidential trade data.

<sup>48</sup> See Wündisch, Karl, “Optimale Organisation des Transfer Pricing als Risk Management Programm,” 2nd edition, Management Circle Verlag, Frankfurt 2007. He is also the co-author of the second revised and enlarged edition of *International Transfer Pricing in the Ethical Pharmaceutical Industry*, International Bureau of Fiscal Documentation, Amsterdam 2003, as well as author of *Pharmaceutical Industry and Transfer Pricing—Anything Special?* *International Transfer Pricing Journal*, November/December 2003, and “Transfer Pricing and Foreign Direct Investment Decisions” (14 *Transfer Pricing Report* 3/31/05).

Such relief must be based on trust and trust is best based on transparent processes. A verifiable, and for that reason also certifiable, transfer pricing policy would facilitate the development of trust. Such a policy would describe not only the basic commitment but also the actual management on the basis of principles for governing transfer pricing in accord with national laws, regulations, and internationally accepted guidelines. Operating on the basis of such a corporate transfer pricing policy entails at its introduction and at intervals thereafter dedicated training programmes for the general managers of the corporate group, their staff as well as those corporate departments with any link to transfer pricing. Transfer pricing professionals of standing, having established such a policy together with a risk management programme and managing it accordingly, should be able to demonstrate a record of limited (even though in some cases such as Brazil unavoidably remaining) exposure and burden from transfer pricing risks.

## Graduate Certificate

The inherently interdependent and sophisticated environment of transfer pricing problem solving seems to suggest that the transfer pricing profession should be recognized through the establishment of a formal academic training and certification process with a dedicated masters degree at graduation. The basis of undergraduate academic training could rest on any of the traditional disciplines, such as law, economics, finance, (international) management, tax or accounting. The greater involvement of national regulatory authorities and the increase in multilateral negotiations would suggest also a move towards and the involvement of students from the political science discipline.

Lorraine Eden, of Texas A&M University, has shown the way by a challenging schedule to study the essential issues involved in transfer pricing for multinational enterprises and nation states. This course, which included the opportunity of gaining practical experiences during internships and which required a final paper comprising the summary of issues addressed by the students during an interview with a senior transfer pricing practitioner, could be used as a reference for further teaching programmes at other universities. As much as Professor Eden, in preparation for her new course, has been communicating with a broad range of practitioners to form an advisory board, such consultations could also include guidance from the OECD’s transfer pricing competence centre. This would allow the development of an international transfer pricing curriculum for universities as standard reference with similar recognition as the OECD guidelines.

Such a curriculum may entail the following subjects:

- multinational enterprises’ structure and modus operandi;
- management interests, business ethics, good corporate citizenship;
- establishing good governance with dedicated transfer pricing policy and risk management programme;
- nation states’ industrial policies relative to their respective level of development;
- transfer pricing as economical and political concept;

- global competition of private firms and governmental authorities for fair trade and equitable income;
- direct and indirect barriers to trade;
- double tax treaties, OECD model convention;
- the arm's-length principle and suggested alternatives;
- transfer pricing methods;
- documentation principles and advance pricing agreements;
- data sources for providing evidence and defence of methods used;
- sector specific approaches considering the use of intangibles;
- transfer pricing cases for illustration of unprecedented risks;
- dispute resolution policies;
- transfer pricing litigation; and
- opinion leadership in transfer pricing—the role of the OECD, the European Union, the United Nations, the United States, the United Kingdom, and Australia.

Those who are following the developments worldwide with unilateral transfer pricing regulations continuously mushrooming, as well as the heated debate among the accounting standard setters for finding common ground,<sup>49</sup> are concerned to know who would be setting which standards for transfer pricing and who internationally should have the authority to develop and to seek agreement on principles-based and, ideally, enforceable transfer pricing guidelines.

The author believes that the political leadership should rest with the OECD. OECD member states—ideally enlarged to match those of the World Trade Organisation (WTO)—should entrust the policy shaping authority to the OECD's transfer pricing competence centre, the Tax Treaty, Transfer Pricing & Financial Transactions Division. This is and has been supported on a continuous basis by the OECD Working Party No. 6 on the Taxation of Multinational Enterprises and BIAC which together during 1995 succeeded as facilitators to find agreement for and to publish the *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

The OECD also follows closely the developments in the European Union by keeping an official observer status at the "EU Joint Transfer Pricing Forum"<sup>50</sup> since its creation by the European Commission in 2001. With joint representation of government officials from now

<sup>49</sup> See, for instance, Simons, M., "If only investors could compare like with like," 13.04.06, and Jopson, B., "Fresh divisions over the unity of standards," Nov. 5, 2006, and U.S. Treasury Secretary Henry Paulson in "The key test of accurate financial reporting is trust," *Financial Times*, June 17, 2007.

<sup>50</sup> The European Commission created in 2001 the EU Joint Transfer Pricing Forum.

For details see the Forum's dedicated Web site: [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/transfer\\_pricing/forum/index\\_en.htm#key\\_documents](http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/forum/index_en.htm#key_documents)

27 EU member states and 15 industry representatives,<sup>51</sup> the Forum is aiming at transfer pricing policy guidance to ease the regulatory burden on business throughout the European Union. During its last term, the Forum has achieved:

- acceptance for settling arbitration among competent authorities within strict time limits; and
- pursuance of APAs to limit the use of resources for transfer pricing audits.

## Conclusion

More than a decade ago after OECD member states agreed on the text and to the publication of the *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, a new political leadership drive appears to be necessary in order to avoid the unilateral issuance of transfer pricing regulations becoming the norm rather than the exception. Similar to the global bridging initiatives between U.S. and European leaders<sup>52</sup> for an agreement on principles-based guidelines and a common accounting language, this should be possible also in the area of transfer pricing.

A long list of transfer pricing issues still remains unresolved, requiring dedicated resources of capable professionals with adequate training. The timing for satisfactory resolution of these issues hinges on allowing for adequate resources at the OECD's competence centre. The political will and determination to develop an internationally recognized career path of academically broadly trained and practically well groomed transfer pricing professionals could prove to significantly reduce the risk of transfer pricing to remain or in some cases even unintentionally to become a non-tariff barrier to international trade.

<sup>51</sup> Following the call for applications for 15 experts from the business sector and for one independent chairman issued Dec. 22, 2006, the Commission April 17 adopted the list of nominated candidates. Chairman: Bruno Gibert, CMS Bureau Francis Lefebvre, France; Members: Håkan Andreasson, tax director, Volvo Group, Sweden; Nicholas Dee, counsel Burt, Staples & Maner, United Kingdom; Eduardo Gracia, head tax department, Ashurst, Spain; Theo Kiejzer, vice president tax policy, Shell International BV, the Netherlands; Guy Kersch, senior transfer pricing counsel, Grant Thornton, Luxembourg; Heinz-Klaus Kroppen, Deloitte & Touche GmbH, Germany; Guglielmo Maisto, founding partner, Maisto e Associati, Italy; Svetla Marinova, senior tax manager, Bulgarian Telecommunications Co., Bulgaria; Kennet Pettersson, tax manager, TeliaSonera AB, Sweden; Michael Sufrin, director of tax, Rolls Royce plc, United Kingdom; Werner Stuffer, vice president taxes, international, Siemens AG, Germany; Monique van Herksen, head European transfer pricing team, Baker & McKenzie, the Netherlands; Dirk van Stappen, KPMG Tax & Legal Advisers, Belgium; Isabel Verlinden, PricewaterhouseCoopers, Belgium; and Sabine Wahl, group transfer pricing director, Sanofi-Aventis, France.

<sup>52</sup> See for instance Ben S. Bernanke, chairman of the U.S. Federal Reserve Board, advising to adopt the U.K. approach "principles-based, risk focused" as a model, *Regulations and Financial Innovation*, May 15, 2007, and U.S. Treasury Secretary Henry Paulson, "The increasing globalization of our markets also means that we must enhance the comparability of foreign company financial statements." in "The key test of accurate financial reporting is trust," *Financial Times*, May 17, 2007, and footnote 4.