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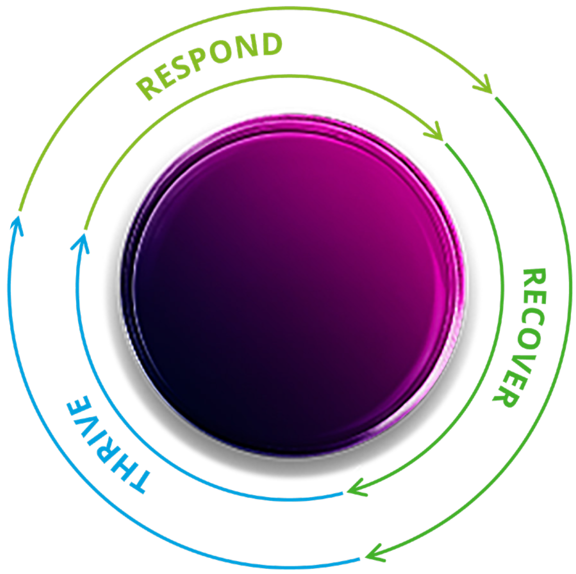
Transfer pricing in an era of Digital Transformation.



COVID-19 has contributed to an acceleration of digital transformation taking place throughout the end-to-end supply chain, with faster and broader adoption of data and predictive analytics, cognitive automation and artificial intelligence, robotics, digital supply chains, smart factories and e-commerce[1].

To help drive better supply chain decisions in real time, understanding the potential impact of digital innovation and transformation throughout the end-to-end supply chain is essential for the tax function. Heads of Tax will need to be able to provide tax guidance on where to align new digital assets and how digital transformation will affect their existing transfer pricing operating models.

How are business exploiting Next-Generation technology?

Through the development and exploitation of Next-Generation technologies businesses are adapting their end-to-end supply chains:

1. By using ***Data Analytics***, businesses are able to access data in their organisation and with data management platforms process this data to make analytical decisions.[2]
2. ***Artificial Intelligence solutions*** enable organisations to design customised experiences around behaviours, preferences and emotions of individual users by using "emotion AI".[3]
3. Cloud technology opens up the opportunity for more businesses to experiment with ***Machine Learning***, which enables businesses to make data driven predictions and business decisions.[4]
4. By using the ability of ***Block Chain***, to track, trace, authenticate products, record contracts, guarantee the movement of information and record transactions, businesses are able to improve and protect consumer experiences, improve process efficiencies across the supply chain, and improve transactions.[5]
5. Businesses are able to streamline, standardise and optimise processes with ***Robotics and Cognitive automation***.
6. Through the capabilities of ***Internet of Things ("IoT")*** businesses are able to remotely track and optimise production assets effectiveness.[6]
7. Business can predict client behaviour, increase process efficiency and optimise maintenance with ***Predictive Analysis*** that uses statistical techniques, such as predictive modelling, machine learning or data mining, to forecast future and unknown events.[7]
8. Companies are able to simulate reality and provide remote training and certification with the use of ***Digital reality***, which consist of augmented reality (AR), virtual reality (VR), mixed reality (MR), 360˚, and immersive technologies.[8]

1 https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-efficient-supply-chain-planning-covid19.pdf
2 https://www2.deloitte.com/uk/en/pages/deloitte-analytics/topics/analytics.html
3 https://www2.deloitte.com/uk/en/insights/focus/tech-trends.html
4 https://www2.deloitte.com/uk/en/pages/digital-transformation/articles/cloud-machine-learning.html
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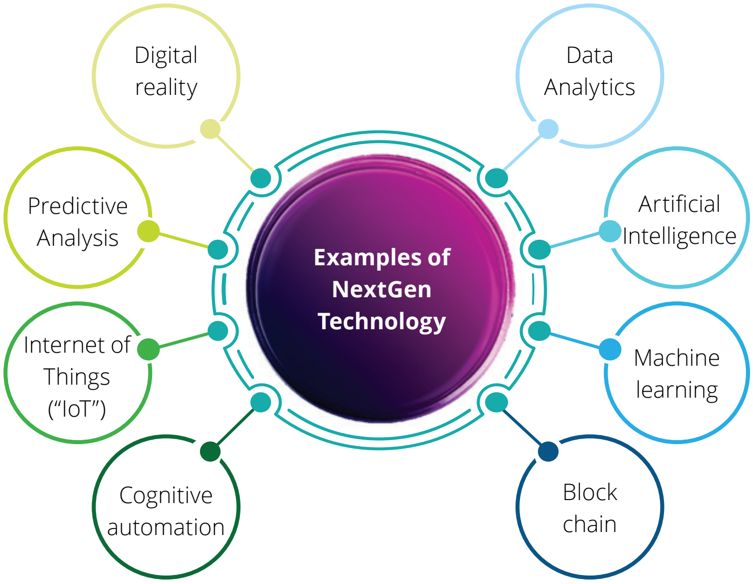
8 https://www2.deloitte.com/us/en/pages/consulting/solutions/digital-reality.html



How might Digital Transformation affect transfer pricing operating models?

COVID-19 has significantly accelerated the digitalisation transformation of many groups. Businesses had to react quickly to continue to be able to communicate with stakeholders, customers and employees. Equally, certain businesses which may have started their digital transformation journey have looked to accelerate their plans to respond to the global pandemic and build a stronger, more resilient business coming out the other side.

Digital transformation may result in changes to the strategic direction of the business, the way the business operates or change how and where value is created, all of which will in turn have transfer pricing implications. Some of these changes may be temporary, whilst others may endure. Some of these changes are set out below.

Changes in employee profile	• Changes in important people functions and their locations • Traditional people functions being replaced by technology • Increased remote & agile working
Shift in value creation	• Transferring value from the physical to the software and from the process or functions to the data.
Creation of New Business Models and Routes-to-Market	• Transition to an online or omni-channel sales model • Transition to Everything-as-a-Service (XaaS) delivery models • More reliance on social media for marketing and customer spending
Changes in Supply Chain	• Digitisation of supply chains • Cutting costs and development of value added services by automating and digitalising operations
Creation and development of new intangibles	• Increasing value of data in respect of analytics and commercialisation • Research and development of data analytics, algorithms, delivery/dashboard, insights and computing power • Through the development of new routes-to-market (e.g. XaaS) new intangibles are created (i.e. know how, strategic processes of delivery models)

Focus from Tax Authorities and the OECD on digital transformation:

The digital transformation of businesses has already been on the agenda of tax authorities and the OECD Inclusive Framework of more than 130 countries for some years and the OECD Secretariat has been leading multilateral efforts to address tax challenges from digitalisation of the economy, including transfer pricing considerations.

Work is ongoing and time will tell if consensus can be reached on the 'Pillar One' proposals (which addresses the allocation of taxing rights between jurisdictions, and seeks to allocate more taxing rights to market countries) and 'Pillar Two' proposals (which seeks to develop rules that would provide jurisdictions with a right to tax profits that would otherwise be taxed at a rate below a 'minimum rate'). At the time of writing, no consensus has been reached on the proposals, with uncertainty on the tax treatment of digital businesses remaining. Developments should be closely monitored and consideration should be given in the design of any transfer pricing operating models of how these proposals may impact the model, in particular the extra profit that may be allocated to local markets remote from the decision making on the digital transformation. In the meantime, however, the pace of transformation in practice means that the transfer pricing analysis can not be stalled until proposals are firmed up. A focus on how to analyse data capture and exploitation from a transfer pricing perspective may be important to help bridge the gap with potential future changes.

How to approach the transfer pricing analysis

As businesses' supply chains experience significant change as part of wider business driven digital transformation initiatives, an organised approach to the transfer pricing analysis is important. A suggested 5-step approach to ensure that value creation continues to align to transfer pricing outcomes is set out below.

1 Reassess the Group's Value Chain

- How has the end-to-end value chain changed due digital transformation
- Map new core value drivers to the value chain
- Map the current and future employee footprint to value drivers

2 Identify new Intangible Assets

- Identify new intangible assets, and consider the interaction of data
- Perform an OECD 6-step Development, Enhancement, Maintenance, Protection and Exploitation ("DEMPE") & Risk analysis for new intangible assets.
- Examine how data is captured, developed, analysed and exploited.

3 Map transfer pricing outcomes with new value creation

- Identify inconsistencies between new value creation and current transfer pricing outcomes.

4 Design/Refine existing transfer pricing operating Model

- Design transfer pricing policies based on go-forward value chain analysis and value creation.

5 Implementation of the transfer pricing operating model

- Drafting new intercompany agreements
- Ensuring financial systems and processes support the new transfer pricing policies
- Drafting transfer pricing documentation in support of any new transfer pricing policies.

In addition to transfer pricing considerations, it is important not to forget other tax and non-tax issues such as: location of assets, indirect taxes, valuations and system requirements.

The COVID-19 crisis has accelerated major shifts in business strategy, advancing widespread digital adoption and reassessment of the end-to-end supply chain – all with significant tax implications. Tax teams should be prepared for the changes to the organisation's value chain.

Get in touch

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