Transfer Pricing Risk Mitigation with ISO 9001 Certification
by K. Olsen

About OGEL

OGEL (Oil, Gas & Energy Law Intelligence): Focusing on recent developments in the area of oil-gas-energy law, regulation, treaties, judicial and arbitral cases, voluntary guidelines, tax and contracting, including the oil-gas-energy geopolitics.

For full Terms & Conditions and subscription rates, please visit our website at www.ogel.org.

Open to all to read and to contribute

OGEL has become the hub of a global professional and academic network. Therefore we invite all those with an interest in oil-gas-energy law and regulation to contribute. We are looking mainly for short comments on recent developments of broad interest. We would like where possible for such comments to be backed-up by provision of in-depth notes and articles (which we will be published in our 'knowledge bank') and primary legal and regulatory materials.

Please contact us at info@ogel.org if you would like to participate in this global network: we are ready to publish relevant and quality contributions with name, photo, and brief biographical description - but we will also accept anonymous ones where there is a good reason. We do not expect contributors to produce long academic articles (though we publish a select number of academic studies either as an advance version or an OGEL-focused republication), but rather concise comments from the author's professional 'workshop'.

OGEL is linked to OGELFORUM, a place for discussion, sharing of insights and intelligence, of relevant issues related in a significant way to oil, gas and energy issues; Policy, legislation, contracting, security strategy, climate change related to energy.
Transfer Pricing Risk Mitigation with ISO 9001 Certification

By ISO Quality Lead Auditor & Chartered Transfer Pricing Specialist Dr. K. Olsen

Summary

The risks associated with transfer pricing have never been as high as they are today, particularly for the energy business, and probably rank among the top three risks faced by multinational corporations in the whole business. One example of these increasing risks is the GlaxoSmithKline settlement with the Inland Revenue Service in the USA a few years ago, when the company had to pay $3.4 billion in tax and had to abandon its claim for a refund of $1.8 billion in overpaid income tax\(^1\). Many other corporations have faced tax bills amounting to billions or hundreds of millions of USD as a result of transfer pricing adjustments\(^2\).

Multinational corporations need to be proactive and be prepared for the worst, and they need to establish a proper tax risk management system\(^3\) in order to be able to identify, analyse, prioritise and mitigate tax risk. One new way of mitigating transfer pricing risk is to achieve ISO 9001 Certification\(^4\) on transfer pricing, which provides strong evidence for all stakeholders showing that their corporation takes transfer pricing seriously. The Central Tax Office for Large Enterprises in Norway has described ISO Certification on transfer pricing as being ‘best practice’.

Introduction

The tax agenda has changed dramatically during the last few years; multinational corporations face more complex tax legislation, more aggressive and skilled tax authorities, more frequent and more thorough tax inspections and disputes with the tax authorities. They could face disputes with the tax authorities in not just one jurisdiction, but in several different jurisdictions at the same time. As soon one dispute has been settled, another dispute could occur in another jurisdiction. Such disputes could end up with adjustments, double taxation, etc.

---


\(^2\) Amazon has faced a $2.2 billion income adjustment relating to a cost-sharing arrangement with a subsidiary in Luxembourg. The IRS took issue with the taxpayer’s transfer of intangible property to its European subsidiary as part of a 2004-06 restructuring. The cost-sharing arrangement included a buy-in for pre-existing technology and marketing intangibles that the IRS valued at more than 20 times the amount negotiated by Amazon and its subsidiary. This case has been assigned for trial to commence in November 2014. Medtronic Inc. is challenging a $2.7 billion adjustment that includes $1.4 billion relating to licensing and manufacturing deals with affiliates in Switzerland and Puerto Rico. This trial has been scheduled to commence in December 2014. Guidant LLC v Comr. (T.C., No 29307-11) is disputing a total of $2.3 billion in an IRS transfer pricing adjustment. Quoted from Bloomberg BNA Tax Management Transfer Pricing Report (2014).

\(^3\) Only 66% of parent company respondents in an E&Y survey identified risk management as being their top transfer pricing priority. *Navigating the choppy waters of international tax. 2013 Global Transfer Pricing Survey.* (2013).

\(^4\) ISO 9001:2008 has been implemented by over one million companies and organisations in over 170 different countries. ISO 9001 Quality Management, http://www.iso.org/iso/home/standards/management-standards/iso_9000.htm.
late interest fees, non-deductible penalties and damage to the company’s reputation, thus affecting share prices, and of course severe economic consequences.

Multinational corporations face higher and new risks, particularly in respect of transfer pricing. The risks are numerous, and each one could be sky-high or even worse; they could all result in cumulative economic consequences. Transfer pricing disputes between corporations and tax authorities and transfer pricing trials are more frequent now than they were just a few years ago, with settlements and court cases more frequently resulting in adjustments and tax consequences to the tune of hundreds of millions or even billions of USD.

Tax advisors around the world are warning businesses about the sky-high risks, red rags and all the negative consequences involved, but still, some multinational corporations are ignoring the risks or wrongly believe that these risks are moderate and acceptable.

It is more important than ever before to be prepared for thorough transfer pricing inspections and the fact that tax authorities in all operating jurisdictions have the willingness and power to challenge large multinational corporations on transfer pricing and international taxation.

A few years ago, hardly any tax managers had heard about tax risk management and very few corporations had implemented a tax risk management system. Managers and advisors were able to devote most of their time to creative tax planning and group structuring. However, the landscape has changed and multinational corporations now need to establish proper tax risk management systems for identifying all the tax risks involved and then analyse them in order to identify any low, moderate or high risks and the likelihood of such risks occurring. Furthermore, it is important to prioritise the risks involved and to find out which risks they need to focus on, e.g. those risks which are more likely to occur and which will have the highest consequences. Once this has been done, corporations can then start to mitigate the most severe tax risks. Unfortunately, not all multinational corporations have done their homework and they are not prepared for tax inspections.

As the tax and transfer pricing landscape has changed dramatically, corporations need to do whatever they can to protect themselves and to be prepared.

One new way of being prepared is to achieve ISO 9001 Certification on a corporation's transfer pricing system from an accredited and independent body such as Intertek Certification or Veritas. ISO 9001 is a quality system, which evidences that corporations have implemented good routines, procedures, internal controls and in-house communications that they have the necessary resources for their work and that they continuously improve their systems. During an Enhanced Relationship meeting with the Central Tax Office for Large Enterprises in Norway, which focused on transfer pricing, the tax inspectors described ISO 9001 Certification on transfer pricing as being ‘best practice’.

**Transfer pricing risks are greater than ever and increasing day by day**

Tax authorities around the world have declared war against transfer pricing; they have acquired greater resources, more highly skilled staff, greater cross-border cooperation and more tax information exchange treaties. Furthermore, governments are needing more money
and are placing pressure on the tax authorities to collect more tax revenue. Transfer pricing has become a red rag for many tax authorities, governments and politicians, and unfortunately, some of them seem to believe that all transfer pricing cases involve irregularities and breaches of transfer pricing legislation, which in turn means higher risks for the multinational corporations.

Some people have described transfer pricing as being double jeopardy\(^5\), but it should be described as being multiple jeopardy, in particular in the energy business where the risks involved are endless:

i) The energy sector has all the excitement one could ever wish for, as multinational participants exchange high volumes of tangible products (oil, gas, chemicals, tools etc.), technical engineering services, loans and technology on an intercompany basis\(^6\). Obviously all this excitement means much higher transfer pricing risks than would be the case for most other businesses.

ii) The tax inspectors or judges in some operating jurisdictions may not be fully qualified in respect of transfer pricing, may not fully understand all the aspects involved or do not know the complex business.

iii) Some countries might implement their own transfer pricing legislation, which might diverge from the OECD Transfer Pricing Guidelines.

iv) It is not necessarily the case that all the countries involved will make corresponding adjustments if one jurisdiction makes a transfer pricing adjustment, and this could result in double taxation\(^7\).

v) The OECD Transfer Pricing Guidelines state that an indirect method for overheads should be accepted. The fact is that, despite claims to the contrary, some countries have not adopted and implemented the OECD Transfer Pricing Guidelines or accepted an indirect method.

vi) The OECD Transfer Pricing Guidelines and the 2010 Report on the Attribution of Profits to Permanent Establishment (and other guidelines) have been written in general terms, thus resulting in weaknesses, uncertainty and of course risk\(^8\) for

---


\(^7\) According to Chapter IV of the OECD Transfer Pricing Guidelines, C2 “tax administration may consider corresponding adjustment”, but they do not have to. Almost one in two parent companies reported in an E&Y survey that they had experienced double taxation as a result of a transfer pricing adjustment. *Navigating the choppy waters of international tax. 2013 Global Transfer Pricing Survey.* (2013). If this is representative and if every second company with adjustments is subjected to double taxation, one might ask whether the main purpose of the tax treaties, namely avoidance of double taxation, has failed. Perhaps the tax authorities are ignoring this important principle in order to obtain as much tax as possible?

multinational corporations, since the tax authorities could interpret these subjectively for their own benefit.

vii) Uncertainty regarding the arm’s length price which should be used. If, for example, the head office in a high-cost jurisdiction, where lawyers normally charge USD 1000-1250 per hour, completes legal work for a subsidiary in a low-cost jurisdiction where lawyers perhaps charge USD 100 per hour, this could result in a dispute and double taxation. The tax authorities in the high-cost jurisdiction might require the head office to invoice the subsidiary for USD 1250, while the tax authorities in the low-cost jurisdiction might accept USD 100 as the arm’s length price.

viii) Some countries use secret comparables, which means that it will difficult for corporations to defend themselves against any adjustments as they have no idea about the reasons behind such adjustments.\(^9\)

ix) Many countries prefer the CUP method, but all corporations are different and there may be no comparable situations. However, the tax authorities still try to compare companies with different strategies, different forms of management, different markets, different customers and different financial situations, etc.

x) Business restructuring is complicated and sometimes corporations may not even be aware that such restructuring has occurred.

xi) The energy sector in particular has many different and valuable intangibles. The transfer pricing situation might be uncertain and it might be difficult to establish a correct arm’s length price for transfers or the use of such intangibles.\(^10\) For example, if an oil company builds a pipeline in another jurisdiction and uses 10 of its best engineers to plan and build it; will any know-how have been transferred or used in the other jurisdiction? If so, what is the correct arm’s length price for such a transaction? The tax authorities focus heavily on intangibles which are very valuable and which could lead to significant adjustments. Since tax authorities around the world focus heavily on intangibles, this serves to increase the risks.

xii) Nobody knows how many trillions of USD in tax are missing around the world, but what we do know is that every government is keen to get its hands on this money. The tax authorities are under pressure from politicians, the public and international organisations and they need to be more efficient and perhaps think outside the box in order to collect more revenue, which in turn will mean higher risks and a greater burden for international businesses.

---

\(^10\) According to Lester, E.E. International Transfer Pricing Rules: Unconventional Wisdom: “The arm’s length principle will generally fail to achieve a comparable market price for ‘intangible’ transactions because they are unique. The unique nature of these transactions creates a wide price range, which makes the market price uncertain” Quoted from ILSA Journal of International and Comparative Law 283-305 (1995).
xiii) In many situations, there are no fixed arm’s length prices. If a company negotiates a contract with 10 different parties, there would probably be 10 different (arm’s length) prices. However, the tax authorities will still expect the company to establish one single arm’s length price. If the tax authorities believes that the chosen arm’s length price is wrong, it will be easy for them to challenge it.

xiv) The energy sector is often established in developing countries where the concept of transfer pricing is new or not very sophisticated. Concerns have been raised because the UN Practical Manual on Transfer Pricing for Developing Countries differs considerably from the OECD Transfer Pricing Guidelines\(^\text{11}\). This creates challenges and additional risks for those energy businesses, which regularly operate in developing countries.

We could continue to list similar risk situations where there are no answers and therefore a high level of uncertainty\(^\text{12}\). Unfortunately, multinational corporations have to bear all these different risks, and even if they do their best to comply with all the transfer pricing regulations or requirements, the risks are still sky high.

Furthermore, an inspection could result in a time-consuming administrative burden, possible litigation and damage the reputation of a corporation, which it may have taken decades to build up. With more complicated and detailed transfer pricing legislation in each jurisdiction, which could differ from one jurisdiction to the next, and more aggressive tax authorities, the risk of cumulative economic consequences will increase because the tax authorities need to protect their tax base. Unfortunately, the taxpayers have to bear all the risks and the risks become higher as the tax authorities become more aggressive.

**Cumulative financial consequences could be sky-high**

During the last few years, there has been a significant increase in the number of transfer pricing inspections, disputes, litigation, adjustments and huge penalties. We have not yet seen the full extent of this and the situation will become much worse during the forthcoming years, with more transfer pricing inspections, more and higher adjustments, complicated disputes and more court cases, with multinational corporations facing tax bills amounting to hundreds or even billions of USD. Transfer pricing has become a minefield with sky-high risks and cumulative economic consequences. Perhaps only incidents like the BP blowout in the Gulf of Mexico will trigger higher risks than the forthcoming transfer pricing battle.

As already mentioned, the cumulative economic consequences of all the risks faced by multinational corporations in respect of transfer pricing are very high, and these risks and their possible consequences are increasing on a daily basis. The worst-case scenario which


multinational corporations need to be prepared for is that they may have to pay more than 100% tax, including significant adjustments, double taxation and non-deductible penalties amounting to several hundred percent, along with damage to their share prices and reputation. Some countries, such as Norway, require full payment of any adjusted tax, penalties and late interest fees even if the assessment carried out has been disputed or gone to litigation. Paying more than 100% in tax possibly 10 years before a dispute has been settled will have a dramatic impact on the cash flow of any corporations.

Transfer pricing risk mitigation

Previously tax managers spent most of their time on creative, legal tax planning. Today, they probably need to devote most of their creativity towards preparing and protecting companies’ tax positions and shareholders’ interest and assets. One way of doing this is to establish and maintain proper tax risk management in the transfer pricing field in order to be able to identify, analyse, prioritise, minimise and evaluate such tax risks.

One example of where tax managers should perhaps be more creative in order to mitigate transfer pricing risks, or perhaps become more involved, is when a petroleum company negotiates a pipeline contract with a government. Some pipeline contracts contain minor tax issues, some contain more detailed tax issues, while others probably have almost no tax issues at all. Surprisingly, hardly any such pipeline contracts contain any detailed transfer pricing issues whatsoever. Transfer pricing has become the most complex, risky and administrative tax issue and one might wonder why the petroleum industry or governments have not been keener to regulate this issue in pipeline contracts.

If transfer pricing was included when a pipeline contract was negotiated, the parties involved could agree on the transfer pricing method, how to establish the arm’s length oil or gas price, the allocation of income, acceptable mark-ups, the allocation of overheads, the rate for royalties and so on. If such transfer pricing issues were agreed and included in pipeline contracts in advance, there would be fewer risks incurred in respect of adjustments, penalties, late interest fees and time-consuming, costly disputes or litigation.

Transfer pricing risk mitigation with ISO 9001 Certification

Another way, and a step forwards, of protecting themselves is to achieve ISO\textsuperscript{14} Certification\textsuperscript{15} on transfer pricing\textsuperscript{16} in order to show that they are compliant and operate in accordance with the legislation and the arm’s length principles of all the operating countries.

\textsuperscript{13} Some examples of penalties from Deloitte 2014 Global Transfer Pricing Country Guide: Belgium 200%, Brazil 225%, Hong Kong, India and Switzerland 300%, Indonesia and Singapore 400%, Luxemburg 1000% (Tax fraud).

\textsuperscript{14} ISO (International Organization for Standardization) is an independent, non-governmental membership organisation and the world’s largest developer of voluntary international standards. http://www.iso.org/iso/home/about.htm.

\textsuperscript{15} Certification – the provision by an independent body of written assurance (a certificate) that the product, service or system in questions meets specific requirements. http://www.iso.org/iso/home/standards/certification.htm.

\textsuperscript{16} In order to mitigate risk further, ISO Certification can also be achieved on Global Tax Risks and Anti-Corruption.
ISO Certification can be achieved for parent companies, for whole groups or for parents and subsidiaries, which are defined as ‘high risk entities’.

ISO Certification on transfer pricing is based on the policies, processes, risk management and documentation, which a company already has in place and can be issued in accordance with the ISO 9001:2008 quality management system or the ISO 31010 risk management system, or a combination of the two.\(^{17}\)

The cost of achieving ISO Certification from an accredited and independent body, and thereby mitigating the tax risks involved, is microscopic compared to all the negative consequences that could result from a transfer pricing investigation and possible adjustments.

ISO Certification does not guarantee that a corporation will avoid all transfer pricing disputes, but it provides very strong evidence of the fact that a corporation operates in line with statutory legislation.

The author of this article has achieved the ISO 9001 Certificate above on behalf of the client\(^{18}\) and when it was put on the table during an Enhanced Relationship meeting, the Central Tax Office for Large Enterprises in Norway described the Certification as being ‘best practice’. They also stated that the ISO Certification evidenced that the multinational corporation took transfer pricing very seriously and that it was compliant. With the ISO Certification on the table, the tax inspectors announced that it was unnecessary to engage in further investigation of the corporation’s transfer pricing activities and they terminated further transfer pricing investigation after one single meeting, which lasted for just 2 hours.

There are several other advantages associated with ISO Certification\(^{19}\) on transfer pricing which multinational corporation should be aware of:

i) It sends a strong, clear message to all stakeholders, including top management, investors, customers, judges and the tax authorities, that a company has implemented satisfactory internal controls and procedures in respect of transfer pricing, which is a legal requirement in most countries.

---

\(^{17}\) ISO 9001:2008 is under revision and the new ISO 9001 standard, which is expected at the end of 2015, will focus more on risk management. [http://www.iso.org/iso/iso9001_revision](http://www.iso.org/iso/iso9001_revision).

\(^{18}\) The client has given permission to promote this certificate.

\(^{19}\) See also [http://www.iso.org/iso/home/standards/benefitsofstandards.htm](http://www.iso.org/iso/home/standards/benefitsofstandards.htm) for further benefits.
ii) It supports the fact that a corporation is operating in line with the OECD Transfer Pricing Guidelines, the EU’s Code of Conduct for transfer pricing documentation and domestic legislation.

iii) It is an evidence of quality, as an international independent, recognised, accredited body confirms that a corporation has implemented satisfactory internal routines, controls, procedures, policies, documentation, internal communications and responsibilities in respect of transfer pricing.

iv) It will force corporation to focus on their transfer pricing risks and deal with them.

v) It will minimise the risks associated with adjustments, late interest fees, double taxation, damage to one’s reputation, time-consuming, costly disputes with the tax authorities and litigation.

vi) The risk of incurring penalties will be reduced as ISO 9001 Certification on transfer pricing emphasises the fact that a corporation will have made a considerable effort to find correct arm’s length prices and establish satisfactory documentation.

vii) It evidences high quality standards on all transfer pricing documentation.

viii) It shows that corporations will make constant improvements to their transfer pricing policies, progress, procedures, internal controls and documentation.

ix) ISO Standards and ISO Certification are recognised worldwide as quality and risk management systems.

x) It will result in cost savings.

xi) Transfer pricing will be more streamlined.

xii) It also proves that corporations have complied with the legal requirements relating to risk management and internal controls.

ISO Certification may not be the most important measure that a corporation might need to implement, but the most important thing is to be prepared...... prepared for thorough transfer pricing investigation, for the uncertainty involved, for the high risks and for the unthinkable. With the declared war on transfer pricing, it is not a question of if multinational corporations will be subjected to tax inspections, but when.

**ISO Standards and Certification**

ISO (International Organization for Standardization) is an independent, non-governmental membership organisation and the world's largest developer of voluntary international
standards, established in 163 countries, which have developed around 19,500 different standards.

International Standards are recognised worldwide and are strategic tools and guidelines designed to help companies tackle some of the most demanding challenges faced by modern businesses. They ensure that business operations are as efficient as possible and they provide practical tools for tackling many of today’s global challenges.20

Corporations, which achieve ISO certification on transfer pricing, will evidence that they focus heavily on both quality and risk. In order to achieve ISO Certification on transfer pricing a company needs to provide the following proof:

- Satisfactory processes, internal controls and procedures.
- The implementation and maintenance of quality management systems.
- Satisfactory documentation.
- Management involvement in transfer pricing.
- Continuous improvements.
- Necessary resources.
- Internal responsibility and communication.
- That the corporation has focus on quality, compliance and risks.

Most corporations will already have these requirements in place and it will be relatively simple to establish the necessary requirements for achieving ISO 9001 or ISO 31010 Certification on a limited area like transfer pricing.

Depending on a corporation's risk assessment, it may just wish to have ISO Certification for its head office, for its high and medium risk subsidiaries or for the whole group.

Certification is valid for 3 years and companies will need to be ISO audited during years 2 and 3. In year 4, certification will need to be renewed, but renewal will be quite simple.

The cost of ISO Certification on transfer pricing will depend on the documentation, policies, procedures and internal controls already put in place by the company concerned, along with the extent of Certification, the size of the company and its internal transactions. As previously mentioned, some corporations face adjustments in the region of several hundred million or even billion USD and the cost of achieving ISO Certification on transfer pricing will be equivalent to paying a microscopic insurance premium when compared to the possible benefits of ISO Certification.

Conclusion

The transfer pricing landscape has changed dramatically during the last few years and multinational corporations such as the energy sector face sky-high transfer pricing risks. The risks are numerous with cumulative economic consequences and they could affect a corporation’s share prices, its reputation and its relationships with governments and its customers. Many multinational corporations will undoubtedly face the unpleasant consequences of transfer pricing adjustments in the future and it is more important than ever 20 ISO, http://www.iso.org/iso/home/standards/benefitsofstandards.htm, last visited on 15 August 2014.
that multinational corporations should be prepared and proactive in order to protect themselves from tax adjustments amounting to hundreds of millions or even billions of USD.

Unfortunately, not all multinational corporations seem to be prepared for a thorough and perhaps a joint multinational transfer pricing investigation\textsuperscript{21}, and even worse; they might not even be fully aware of all the high risks involved and of all the negative consequences that they might face in respect of transfer pricing.

There are many ways of protecting themselves from significant transfer pricing adjustments, e.g. by establishing and implementing the arm’s length principle, establishing proper and well-founded documentation, signing written agreements, documenting comparables, establishing transfer pricing policies and routines and ensuring that their policies and procedures are actually adhered to. They should try to avoid all red rags, including aggressive tax planning, and establish proper tax risk management in order to be able to identify, analyse, prioritise and mitigate the highest risks.

For anyone wishing to go a step further, ISO 9001 or ISO 31010 Certification on transfer pricing granted by an independent accredited body will serve as a cheap insurance policy and be an important step forwards in respect of reducing the risks involved.

Regardless of the approach chosen, multinational corporations need to be aware of the very high and cumulative transfer pricing risks involved and they will need to implement proper tax risk management in order to mitigate these risks. More importantly, they will need to act before the tax inspectors come knocking at their door, as it is not a matter \textit{if} the inspectors will come knocking, but \textit{when} they will appear on the doorstep.

\textsuperscript{21} A joint tax inspection where tax authorities across the world cooperate on inspecting an individual corporation is something that corporations will see more of in the future as the OECD has proposed having more effective tax inspections. See OECD, \textit{Sixth Meeting of the OECD Forum on Tax Administration, Istanbul, 15-16 September 2010. Joint Audit Report}. 