Leading practices for integrating tax and transfer pricing requirements with enterprise resource planning (ERP) for multinational enterprises

The intersection of ERP systems and transfer pricing

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Rapid expansion creates challenges in tax and transfer pricing integration of ERP systems

As multinational enterprises continue to expand through acquisition and organic growth, the need for accurate and timely reporting of operational and financial data has never been more critical. Companies rely on their management information systems to deliver reports that enable corporate executives to make informed decisions in real time. However, rapid expansion – particularly through acquisition – can result in companies having an excess of accounting, supply chain, human resources, and other systems and software platforms that often cannot be integrated easily.

These systems gaps result in poor management reporting and are of even greater concern for multinational enterprises with a high volume of intercompany transactions. The ability to accurately price, record, and report transfers of tangible goods, licenses or sales of intellectual property, and the provision of services and financing between related parties - or transfer pricing - is critical to correct and timely tax reporting domestically and abroad. Poor tracking of transfer prices translates to increased enterprise risk and a possible impact to the bottom line.

Corporate executives within multinational businesses must work cross-functionally – bridging operational, financial, and information management systems – to integrate tax and transfer pricing requirements into their enterprise resource planning systems.

Leading practices for integrating tax and transfer pricing requirements

Although there are complexities in integrating tax and transfer pricing requirements into an existing ERP system, companies can take certain practical steps to close gaps and improve data collection and reporting. As a threshold matter, generally companies are most successful when they leverage core ERP functionality rather than trying to fit the ERP into what may be a jumble of existing manual processes and incompatible software.

Alignment of policy and execution. To the extent that companies can employ their ERP system to execute the transfer pricing policy, gaps between policy and execution are narrowed.

Early communication on integration efforts can save costs in the long run

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Leading practices direct that tax departments communicate their user requirements to the ERP system team early in the implementation process and work closely with their management information systems colleagues to achieve appropriate integration. Many companies have rejected this approach because the upfront set up costs can be high. However, when compared to the cost of remediating these disparities on an annual basis, the initial expense is often significantly less in the long term.

Moreover, ERP system upgrades do not always keep pace with growing geographic footprints or operational expansion, particularly in newer companies. Often the frugal and entrepreneurial mindset of an emerging multinational enterprise translates into systems that lag behind the needs of the business over time. Commonly, new businesses start out with several desktop-based tools to manage transfer pricing. These systems tend to be harder to scale and less robust than enterprise systems which aim to synthesise and integrate virtually all functional areas across a business.

Issues with desktop-based tools appear when companies try to generate segmented profit and loss statements by legal entity that incorporate tax and transfer pricing adjustments. Leading practices dictate that companies prepare these financials by leveraging an ERP or business intelligence (BI) system to ensure accuracy and completeness. Similarly, many companies rely on spreadsheet models to determine overhead and headquarters cost allocations. These documents are often used year after year without considering structural changes internally, such as the addition of new cost centers, and externally, including modification of local tax rules.

Corporate information management executives and their advisors are well advised to consider user requirements carefully and to select scalable, enterprise-wide systems that have the capabilities to meet the changing needs of the business.

Taking the time to understand & leverage available information is key for choosing best transfer pricing policies

Know your data. Often, the ERP system is perceived as a so-called "black box" as opposed to a key tool that gives tax departments visibility into critical financial detail. This distinction is important because, from a price-setting perspective, companies need to identify all cost elements – including cost of goods and inventory variance and customs

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duties. Specifically, tax departments can leverage the detailed cost data buried within ERP systems to make better decisions, set appropriate policies, and enhance the quality of their transfer pricing documentation. It is a leading practice for corporate tax personnel to invest the time and effort to understand what information is available and leverage that knowledge to select the best transfer pricing policy for each transaction based on the granularity of data available and the ability of the system to accurately calculate and record the transfer price.

Management does not typically prepare forecasts on a legal entity or product segmentation basis. This data is important though for setting and managing transfer pricing targets. It is recommended that finance and transfer pricing personnel work as a team to monitor planning systems. Invoice generation is another key concern. The proper level of detail must be included in the invoice for both income and indirect tax purposes. Single, lump sum invoices may be rejected by tax authorities who want visibility into cost of goods versus other operating expenses.

Appropriate configuration. Closely related to the integrity of the data contained within an ERP system is the quality of the outputs it generates. As tax and transfer pricing compliance is not limited to tax returns and written reports, supporting documentation is a key part of substantiating and, when necessary, defending tax positions. This additional support may include invoices, expense reports, and executed agreements with both related and third parties, among other things. Configuring the data warehouse, general ledger, and other information caches to generate useful outputs is a leading practice for multinational enterprises. Specifically, companies should consider how their ERP system manages trading parties to track intercompany sales, which can be challenging if the appropriate modules are not in place to monitor related customer or vendor lists. Incorporating terms, such as INCOTERMS, is also a key consideration. Instead of manually capturing the movement of goods, companies should leverage the ability of ERP systems to configure flash title transfers for drop shipments and other transactions. ERP systems are also able, through customisable modules, to manage parallel valuation of goods dynamically, allowing for the tracking of cost in both management and tax accounting instances.

Cross-functional collaboration. Implementing and maintaining an efficient ERP system requires coordination and communication across corporate departments

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Successful ERP systems require a team effort – and good communication

and operational business units. Understanding the user requirements of groups ranging from design and engineering to marketing, legal, tax, accounting, regulatory compliance, information technology, and treasury helps to develop a system that truly integrates the business and allows for real-time strategic and tactical decision-making. Especially important for multinational enterprises is the involvement of the tax department to understand additional reporting or data capture that may be necessary as the business evolves, the company enters new markets, or tax laws change.

Depending on the intercompany pricing policy, transfer prices may need to be submitted to finance as absolute prices, a mark-up on standard cost, a discount from a list price, or another mechanism. Proper communication between departments and propagation within the ERP system is paramount. For example, the controller group should be made aware of interest payments, unrealised inventory profit, and year-end true up adjustments.

More is not necessarily better. Although an excess of add-on modules is available for most ERP systems, multinationals are well advised to use moderation and restraint when it comes to adding supplemental systems

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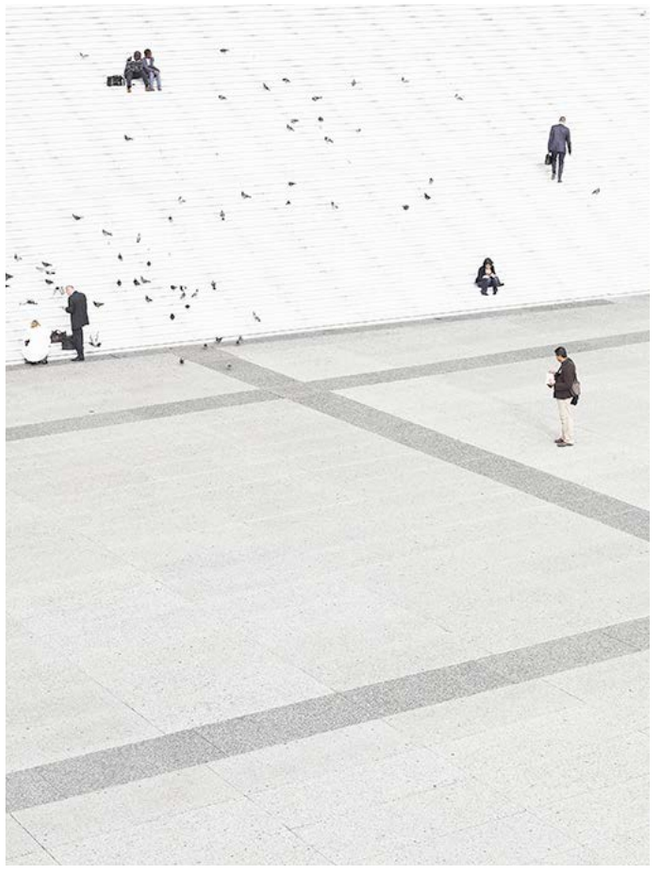
to their existing ERP. Carefully evaluating the cost and the benefits of additional modules is necessary to avoid creating a system that is unwieldy and disjointed. At the same time, businesses should also be vigilant in creating exit strategies for legacy systems. Particularly a concern for highly acquisitive companies, often there are significant intervals between the time a new company is purchased and the sunset of its previous systems. With older software, compatibility issues frequently arise that result in the need for manual actions to translate data from one system to another. These added steps create opportunities for potentially costly errors.

Generally, companies that seize upon corporate lifecycle events – mergers, divestitures, acquisitions, and reorganisations - as a springboard to enhance and realign ERP systems with the business are better positioned to mitigate enterprise risk.

Return on investment. When tax and transfer pricing integration with ERP systems becomes a business imperative, companies are better able to leverage their systems to monitor profit level in local jurisdictions - enabling business results that are consistent with the economic realities and the functions performed, assets employed, and risks borne - and closely track the enterprise's effective tax rate (ETR). Understanding the drivers of ETR in real time can help corporate tax and finance professionals quickly to identify unutilised deductions and non-beneficial transactions that do not support the business and take action to remedy the situation.

It is vital that corporate management information systems professionals work together within their organisation - especially with their tax, treasury, and finance colleagues - to guide the development, implementation, and on-going maintenance of the ERP system. Ultimately, the ability to report and analyse operational financial data in real-time typically turns to increased profitability and the easing of enterprise risk.



Making tax & transfer pricing integration with ERP systems a priority benefits the business

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