Protect Your Business from Transfer Pricing Risks with a Global EOR

How a Global EOR mitigates the challenges with transfer pricing compliance

THOUGHT LEADERSHIP

GLOBAL EXPANSION

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MANAGING THE UNIQUE CHALLENGES OF TRANSFER PRICING COMPLIANCE

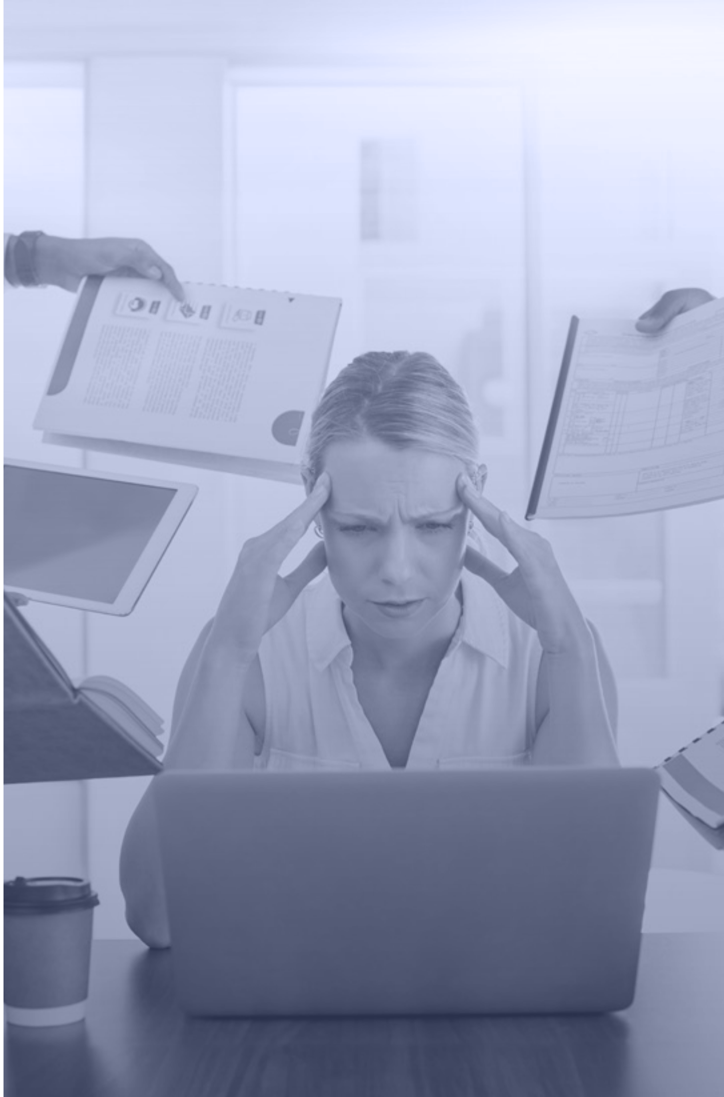
Technology has boosted global growth, blurring country boundaries, and breaking barriers worldwide.

Today, conducting business globally is no longer limited to multinational corporations. Small and medium-sized enterprises (SMEs) are now expanding to international markets.

However, unlike multinational companies, SMEs lack the infrastructure and capital to operate in foreign countries while ensuring legal compliance. As a result, SMEs can transfer administrative tasks associated with HR and tax compliance to a Global Employer of Record (EOR), which is responsible for ensuring compliance and paying taxes on behalf of their clients.

However, cross-border businesses are often exposed to corporate tax issues, especially transfer pricing risks.

A Global EOR can help its clients deal with the challenges associated with transfer pricing compliance and so much more.



Methodology

Extensive research was conducted to prepare this report. Government publications, international publications (e.g. Organization for Economic Co-operation and Development [OECD] documents), Big 4 accounting firms (PWC, Deloitte, and EY), and peer-reviewed journal articles were mainly used to write this report. The findings were further complemented by various websites and articles.

Global EOR

Global EOR services are growing in popularity due to their countless benefits to small and medium-sized businesses. The rise of the Global EOR market is fueled by the exponential growth of SMEs, especially those seeking to expand or initiate business operations overseas.

A Global EOR is configured in a specialized manner, offering various HR services to SME clients.

These services include handling:

- Employee payroll
- Benefits (via mutually agreed benefit plans with insurance firms)
- Employees' compensation
- Human resource compliance

Moreover, Global EOR services usually operate as well-known and officially recognized legal entities with business IDs and payroll registration in different parts of the world.

They operate as the official employer for tax purposes which allows it to eliminate any common tax and legal obstacles, helping them facilitate SMEs in foreign jurisdictions.

To reap the benefits of a Global EOR, clients must sign a co-employment contract with it, thereby making it the official Employer of Record in the designated country.

Certain nations require the EOR to be legally certified and officially recognized. For instance, US law requires an EOR to be endorsed by the Employer Services Assurance Corporation (ESAC) to prove that they are compliant with industry guidelines. A Global EOR must contact the relevant country's employment regulators to make sure that they are not in breach of any domestic laws.

These agreements have proven to be extremely beneficial for companies with limited resources. In exchange for a small fee, an EOR not only handles all administrative tasks associated with HR operations in a foreign territory but also ensures that these companies aren't breaking any local or international laws.

This allows companies to focus on their primary product or service instead of wasting resources on administrative tasks.

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DECODING TRANSFER PRICING

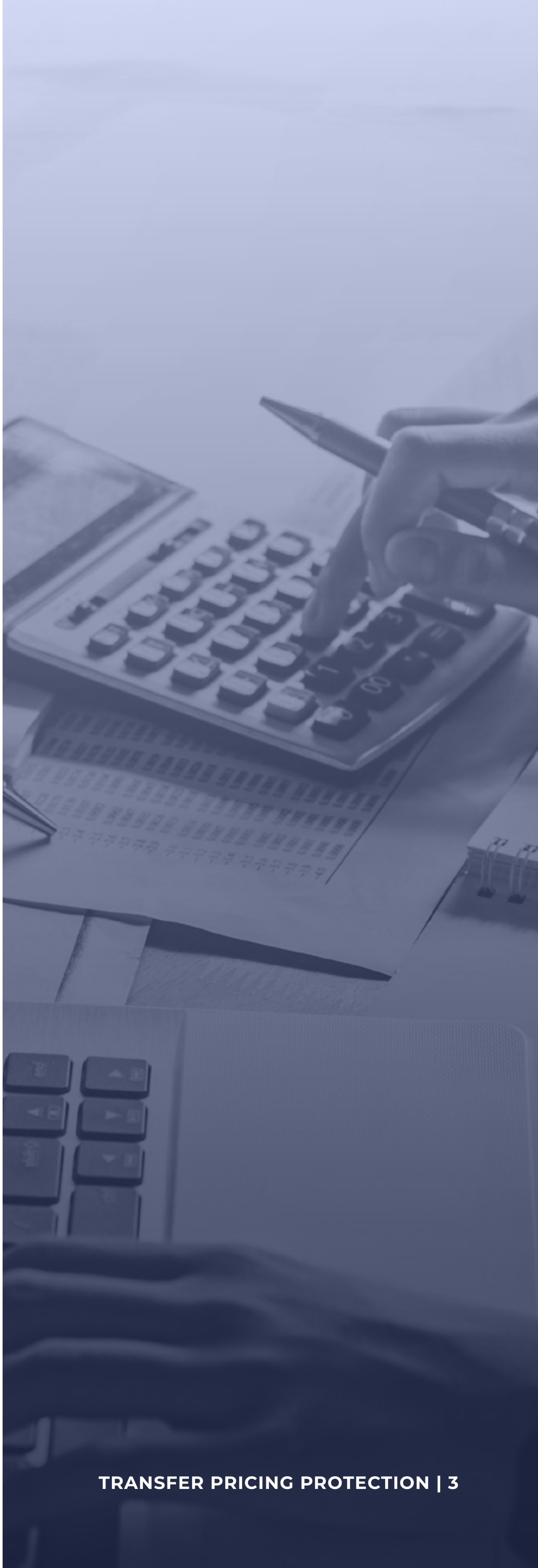
Transfer pricing is an accounting technique applicable to charging different divisions or segments of a company for goods and services sold. This principle is usually used when different divisions act as separate profit centers.

Transfer pricing is founded on the arm's length principle, a strong basis for determining prices of goods and services exchanged between controlled parties.

According to the arm's length principle, entities that are associated through management, control, or investment in their controlled transactions should abide by similar terms and conditions that would have been mutually decided between unrelated entities for similar uncontrolled transactions.

Multinationals operating at a large scale often have complex transactions due to their size, making it rather difficult to use the arm's length principle in a manner that complies with tax regulations.

Tax authorities around the globe are also increasingly concerned about the possibility of multinational companies using transfer pricing and specifically the arm's length principle to avoid and evade tax by shifting profits to tax havens.



Curbing Tax Avoidance & Evasion

Tax avoidance and tax evasion is an extremely important issue that is taking center stage at all political and governmental levels. This was partly driven by the infamous leaks of Panama Papers and Paradise Paper, which revealed the extent of tax evasion by corporations and high-net-worth individuals by using offshore accounts.

Now, tax authorities and regulators are implementing concrete measures to curb tax evasion, helping to increase the scrutiny and due diligence by tax authorities regarding transfer pricing.

Findings suggest that around 57% of tax administrators and 48% of corporations consider transfer pricing to be the most significant tax compliance risk. Business leaders around the world are faced with serious challenges stemming from the risk of non-compliance with transfer pricing regulations.

These include violating transfer pricing rules and double taxation by companies. On the other hand, tax regulators are concerned with transfer pricing as they seek to reduce profit shifting, revenue losses, and ultimately counteract any form of tax evasion.

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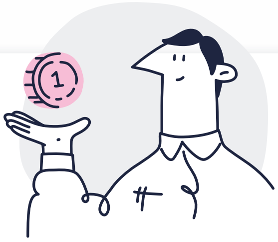
EFFECTIVE STRATEGIES TO LESSEN TRANSFER PRICING RISK WITH A GLOBAL EOR



Transfer Pricing Risk

Transfer pricing has become a key cornerstone of tax planning and regulation. It requires specialized knowledge and expertise about different countries and tax jurisdictions.

Therefore, transfer pricing specialists should not only be local professionals but also be capable of occupying transnational spaces. These specialists are experienced as they undertake practical measures to ensure that businesses are compliant with the arm's length principle with regard to allocating profits between different jurisdictions.

Companies operating in more than one territory often struggle with determining their taxable profit and reaching an agreement with various tax administrations regarding the appropriate share of taxable income in their jurisdiction.

Organizations are increasingly using Global EOR services to efficiently manage their corporate risk, ranging from permanent establishment risk, and transfer pricing risk to payroll compliance.

Mitigation

A Global EOR is ultimately responsible for calculating and paying the taxes of its clients in addition to ensuring compliance with local laws and regulations.

That's why an EOR conducts due diligence, keeps up to date with the tax laws in a particular jurisdiction, and keeps up to date with any changes in the local laws. A Global EOR can play an instrumental role in mitigating transfer pricing risk in the following ways.

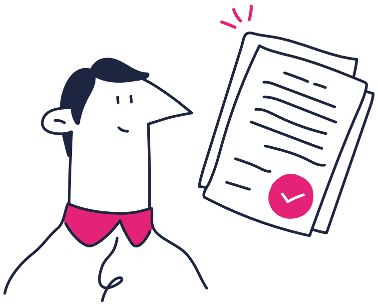
A Global EOR Maintains Extensive Documentation

A Global EOR can mitigate transfer pricing risk by expanding its documentation efforts. All transfer pricing documents should be available, accurate, and up to date.

Companies conducting business in foreign jurisdictions understand well conceptualized and consistent transfer pricing structure is crucial to lowering transfer pricing tax risk.

Taxation and regulations, especially on the OECD platform, are rapidly evolving, Thus, businesses, especially those with multifaceted or digital business models with a lot of intellectual property, should evaluate and assess draft reports and documents as soon as they become available.

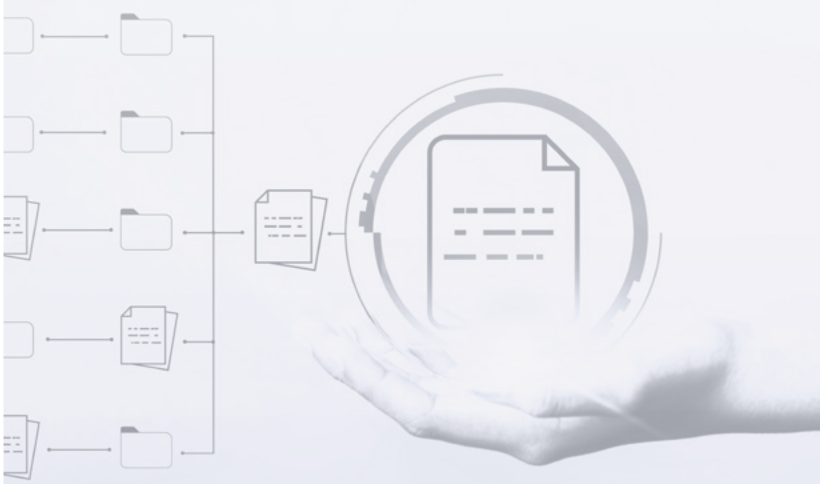
A Global EOR must maintain documents of intercompany transactions (i.e. those transactions between the EOR and their clients). Additionally, they must maintain all documents related to transfer pricing and their client's taxable profit.



This allows them to comprehend and predict tax changes beforehand and then make contingency plans to deal with the changing tax regulations. An EOR plays a crucial role in facilitating ongoing monitoring and assessment of local tax laws and regulations.

The most important way to mitigate transfer pricing risk is having proper and periodically updated documentation as this allows an EOR to be well-equipped and prepared if tax authorities decide to conduct an audit.

This extensive documentation usually acts as an initial roadmap for tax authorities that are seeking corroboration for deductions and evidence proving compliance with transfer pricing requirements.

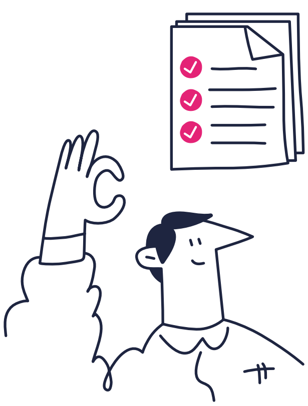


A Global EOR Ensures Intercompany Service Agreements

Global PEOs can further mitigate transfer pricing risk by ensuring intercompany service agreements. A Global EOR supports its clients with functions such as HR, payroll management, and compliance with tax laws.

To ensure transparency and legality, an EOR must sign a co-employment agreement with their clients. This will allow them to ensure that all financial transactions between the two parties are well-documented and on record. Tax regulators and authorities usually ask for intercompany agreements whilst reviewing compliance with transfer pricing.

Tax authorities and regulators will particularly be concerned with intercompany service agreements for employees who frequently work in more than one jurisdiction.



This is because the tax authorities are seeking to ensure that their arrangements abide by the arm's length principle and that the contractual agreement corresponds with the value of services completed.

Furthermore, highly skilled employees with specialized knowledge and expertise who frequently travel between countries are considered to be transferring intellectual property.

It is therefore important for tax directors to determine whether their intercompany pricing of services captures such value. A Global EOR can facilitate tax directors as they are responsible for managing the employees.

A Global EOR Addresses Challenges Associated with Disparity Between Transfer Pricing Laws

There can be a disparity between local and international rules regarding transfer pricing. The Organization for Economic Co-operation and Development (OECD) offers rules and regulations regarding transfer pricing via their Base Erosion and Profit Shifting (BEPS) initiative.

In 2019, they added country profiles on transfer pricing for Chile, Finland, and Italy containing information on OECD transfer pricing rules and the local transfer pricing guidelines, respectively. OECD possesses transfer pricing country profiles of 55 countries.

This can be used by Global PEOs to help with transfer pricing compliance. Currently, the OECD has 38 countries that are active members. Consequently, these countries abide by the arm's length principle laid out by the OECD.

These include countries such as the United States, the United Kingdom, Turkey, Japan, Canada, and Australia. However, most of the countries around the world are not members of the OECD. Hence, these countries have their domestic transfer pricing laws that may differ from those proposed by the OECD.

A Global EOR can play an instrumental role in such circumstances where countries are not following international guidelines on transfer pricing. It will usually be based in the local country, and will be familiar with the domestic laws and regulations. This would give them an edge over those working remotely from the head office of a company.

An EOR is usually based in countries where their clients are subject to tax, even though the head offices of their clients are located elsewhere. Companies need to ensure that their intercompany transactions are not breaching the local laws related to transfer pricing or the arm's length principle.

A Global EOR has a locational advantage over its clients. They are well versed with the local laws of the jurisdiction where the company is paying taxes, and they understand the business environment in general.

They can conduct and stay on top of local transfer pricing laws and regulations much faster than if their clients were operating independently from their respective countries. In certain cases, they are also aware of proposed changes even before they have been approved, helping them predict and prepare for any changes in the transfer pricing laws in order to address changing circumstances.

A Global EOR Allows Their Clients to Take a More Holistic Approach to Transfer Pricing

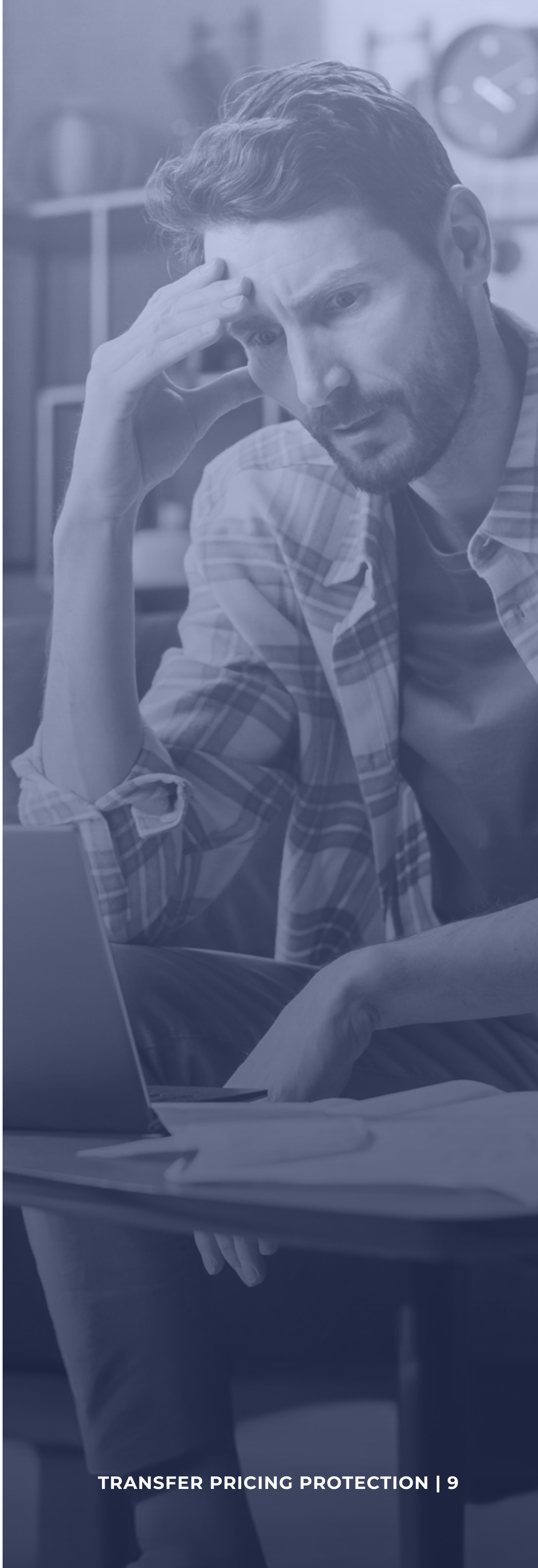
Around 40% of company executives argue that challenges to transfer pricing (TP) over the past 3 years have led to double taxation.

This shows that transfer pricing risk is extremely high. Companies, especially those with limited resources and capital, need help to not only ensure compliance, but also to avoid double taxation due to miscalculation, and erroneously paying taxes in both where the SME head office is and where the Employer of Record is located.

Companies are unable to ensure compliance with transfer pricing regulations in all the countries in which they operate. That's why they usually focus only on the high tax risk jurisdictions.

However, scrutiny over taxation and transfer pricing in particular is increasing. To mitigate transfer pricing risk, it is important to ensure a more holistic approach and involve all countries. This can be done by using an EOR.

A Global EOR has teams that can help their clients ensure compliance in most of the jurisdictions in which they operate.



A Global EOR Combines Corporate Tax and HR in a Seamless Manner

The Base Erosion and Profit Shifting (BEPS) initiative by the OECD entails a high level of due diligence with regard to the maintenance of proper documentation and the employment structure facilitating employment activities that take place in more than one nation.

Businesses must ensure that they have internal controls that enable them to track and report mobile employees and understand the exact type of work-related responsibilities that they are undertaking.

Companies will need cooperation and coordination with their corporate tax departments to maintain suitable transfer pricing policies. They must also make sure that recharges correspond with transfer pricing regulations so they can truthfully capture the actual work performed and the value created in each legal jurisdiction.

Additionally, corporate tax must corroborate and communicate with the HR and global mobility departments whilst discussing and strategizing foreign operations and international tax planning.

It is imperative that the Tax and HR departments are in communication with one another, and must form a holistic approach since there can be some differences between personal and corporate tax purposes.

A Global EOR plays an instrumental role in mitigating transfer pricing risk as it interconnects corporate tax and HR functions in a seamless manner. It is responsible for managing HR functions.

Additionally, it is also responsible for compliance with corporate taxes, helping them connect the mobile workforce, HR functions, and corporate taxation seamlessly.

04

CONCLUSION

This guide demonstrates the way companies can mitigate transfer pricing risk by using a Global EOR. Transfer pricing risk mainly stems from mispricing intercompany service agreements or transactions between related parties.

There is a risk that companies may pay more tax than they are liable to pay due to a lack of understanding of the transfer pricing laws. Additionally, governments are also increasingly concerned with transfer pricing as they believe that companies can use loopholes in the transfer pricing laws to transfer their profits to tax havens and evade paying taxes.

A Global EOR can help mitigate transfer pricing risks in 5 key ways:

- Maintaining extensive documentation
- Ensuring intercompany service agreements
- Addressing challenges associated with disparity between transfer pricing laws
- Allowing their clients to take a more holistic approach to transfer pricing
- Interconnecting corporate tax and HR functions in a seamless manner.

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