KNOW GREATER VALUE™

PKF O'CONNOR DAVIES
ACCOUNTANTS AND ADVISORS

Tax Notes

Blockchain Technology and Transfer Pricing

By David Slemmer, Principal

Blockchain is an emerging technology that could revolutionize business. Although the technology is still in its early stages and has not been widely adopted by the business community, many are excited about its potential to fundamentally transform business. Blockchain enthusiasts cite the technology's potential to enhance the reliability of transactional records.

This article examines the ways blockchain technology could potentially transform transfer pricing by providing reliable documentation supporting international transactions.

What Is Blockchain?

Blockchain technology originated with Bitcoin, but the technology has potential for use in many other applications.

Simply put: a blockchain is a record of transactions, similar to a ledger. Blockchain can be used to record sales of goods or the issuance of a license. Unlike traditional ledgers, blockchain technology makes it virtually impossible to secretly alter those records.

How It Works

Blockchain is perhaps most easily understood by looking at an example. Assume USNL is a U.S. company with a distribution warehouse in the Netherlands. The Dutch division of USNL sells EUR 1 million of goods to a third party customer in Germany. If USNL uses an accounting system that relies on blockchain, how would accounting for the transaction change?

The computers of both USNL and its German customer will share the transaction with other computers in the blockchain network by creating a block. This block will show information about the transaction, such as a description of the goods sold, the amount of goods, the price, and the exact date of the transaction. Worth mentioning is that only the metadata[1] of the transaction would be stored on all the nodes/participants within the blockchain, ***not the content of the relevant transaction***. The latter will only be visible to the participants who have authorization rights to see the transaction details as a whole.

Intertwining of Relevant Records

This block (the aforementioned relevant transaction) would then be chained to other blocks that record prior intermediate transactions. For example, the block recording the sale to the German company would be attached to the block recording the sale from the U.S. to the Netherlands, which would be attached to USNL's purchase of raw materials. In theory, all of the intermediate transactions leading up to the EUR 1 million sale will be recorded, time stamped, and chained together. Thus, the blockchain creates a chain of

[1] Metadata is "data that provides information about other data"

transactional records that could be traced from Germany, back to the Netherlands, back to the United States, and beyond.

Any attempt to alter a pre-existing block will affect the way that block attaches to the chain, causing a mismatch, which will reverberate throughout all subsequent blocks. This transparency is the key to blockchain's potential to facilitate trust.

Blockchain and Transfer Pricing

Blockchain could provide tax authorities a more reliable audit trail. For example, a blockchain could show where a related-party transaction originated, exactly when it occurred, and the terms under which it occurred. Some hope that blockchain will more clearly show the development, enhancement, maintenance, protection, and exploitation of intangibles by creating a trail back to the location(s) of value creation. For example, the technology can track where a software code is written as well as where it is used.

It could also be used to get some sense of the aggregate or group profit associated with a series of interconnected transactions, allowing for some sort of profit split analysis across the group. Whether such a profit split would be used as a method or simply some sort of "sanity check" by tax authorities is something to think about, but the potential for such an analysis could be there regardless. Finally, blockchains could provide highly reliable and contemporaneous records of transactions that substantiate the information contained in master files and local files.

Potential as Transfer Pricing Tool

At present, blockchain technology is relatively new and not widely used. However, it could potentially be a game changer for transfer pricing. While blockchain is not likely to eliminate the informational disadvantage tax authorities face when auditing transactions with foreign affiliates, blockchain could shed light on the supply chain of an MNE (multinational enterprise) and reduce the knowledge gap. A blockchain could also enhance the reliability of transfer pricing documentation and accounting records, which could reduce compliance and audit defense costs.

Contact Us

For information about this article or if your need assistance with transfer pricing matters, please contact David Slemmer, Principal at dslemmer@pkfod.com or 646.965.7781 or your PKF O'Connor Davies tax advisor.

About PKF O'Connor Davies

PKF O'Connor Davies, LLP is a full-service certified public accounting and advisory firm with a long history of serving clients both domestically and internationally. With roots tracing to 1891, nine offices in New York, New Jersey, Connecticut and Maryland, and more than 700 professionals, the Firm provides a complete range of accounting, auditing, tax and management advisory services. PKF O'Connor Davies is ranked 28th on *Accounting Today's* 2017 "Top 100 Firms" list and is recognized as one of the "Top 10 Fastest-Growing Firms." PKF O'Connor Davies is also recognized as a "Leader in Audit and Accounting" and is ranked among the "Top Firms in the Mid-Atlantic," by *Accounting Today.* In 2017, PKF O'Connor Davies was named one of the 50 best accounting employers to work for in North America, by *Vault*.

PKF O'Connor Davies is the lead North American representative in PKF International, a global network of legally independent accounting and advisory firms located in over 400 locations, in 150 countries around the world.