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Transfer Pricing Tax Year-End Considerations

Analysis that matters from Washington National Tax and Meijburg & Co

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This article covers some key year-end international tax and transfer pricing planning issues including:

- Pillar One's Amount B
- Pillar Two compliance and planning
- Public country-by-country (CbC) reporting
- Volatile interest rates and tightening of regulatory restrictions
- Planning for evolving business models
- Transfer pricing controversy
- Issues arising from year-end adjustments
- Key upcoming changes in the transfer pricing compliance landscape

2024 has been another interesting year in the world of international tax and transfer pricing. Companies have focused heavily on Pillar Two (minimum tax) from a compliance and planning perspective with it coming into effect on January 1, 2024, in many countries, including in most countries in the European Union, the United Kingdom, Australia, Canada, and South Korea. 2025 looks to be another dynamic year with Pillar One Amount B (transfer pricing simplification measure for routine distributors) becoming effective in some countries as of January 2025, and public CbC regulations coming into effect.

All of these developments have important implications for international tax and transfer pricing and should factor into how multinational entities (MNEs) are thinking about the future.

Pillar One's Amount B

Going into 2025, MNEs should start to think about the potential implications of Amount B—the OECD's project to simplify and streamline the application of the arm's length principle to so-called "baseline marketing and distribution activities." On February 19, 2024, the OECD/G20 Inclusive Framework on BEPS released a report on Amount B of Pillar One, the contents of which have been incorporated into the OECD Transfer Pricing Guidelines. The implementation of Amount B is optional for countries, and we still do not have a full picture of countries that will ultimately adopt it. However, it is clear Amount B—and the returns it provides for—will serve as a reference point for tax authorities around the world. We have already seen tax authorities consider Amount B in advance pricing agreement (APA) negotiations. Argentina, Brazil, Mexico, and South Africa have indicated they are inclined to implement Amount B—and the United States remains extremely supportive of the project, so U.S. inbounds should keep watching this space. The Netherlands on the other hand, has just indicated in a Decree not to apply Amount B in domestic situations, but to respect Amount B for the so-called covered jurisdictions.

MNEs should review the distributors in their supply chain to determine if they are likely to be in scope of Amount B and, if so, perform modelling to understand the impact of the pricing matrix vis-à-vis their existing transfer pricing. Some MNEs—depending on the results of their modelling—may want to consider potential steps to ensure that they are more clearly included or excluded from Amount B. The OECD's use of operating asset intensity places an imperative on having accurate balance sheet data—which some MNEs have struggled to obtain, especially if distribution activities have to be segmented out.

While Amount B will change how returns are determined for in-scope distributors in countries that decide to adopt it, it does not envision a radical overhaul of transfer pricing documentation. Instead, distributors within the scope of Amount B will continue to need transfer pricing documentation much like what exists today; only the benchmarking section will be replaced with a description of the application of Amount B. For distributors that participate in intercompany transactions involving counterparty jurisdictions that do not adopt Amount B, documentation may become more rather than less complex, requiring both an Amount B analysis and, for the non-Amount B jurisdiction, traditional benchmarking.

Pillar Two Compliance and Mitigation

2024 was the year that Pillar Two finally came into effect, with an initial focus primarily on Europe, Australia, Canada, Japan, and South Korea. Almost every MNE has been spending significant time preparing for Pillar Two-related compliance burdens. While the 2024 focus was mostly on the Transitional CbC Safe Harbor, on a longer-term basis (or earlier to the extent operations fall outside the Transitional Safe Harbor), MNEs need to ensure they have the myriad of data required for Pillar Two compliance. This involves reviewing their Pillar Two calculations, identifying data gaps, and working across different functional groups to bridge those gaps.

As the dust settles on Pillar Two, many MNEs are moving from assessing its impact to planning. For example, MNEs are evaluating options for restructuring to maximize the benefit provided by jurisdiction blending, the benefit of the substance-based income exclusion, or new incentives regimes that governments are introducing in response to Pillar Two. MNEs may also consider restructuring out of jurisdictions that are no longer aligned with their business needs in favor of jurisdictions that are better aligned with such business needs, particularly where this leads to a better Pillar Two outcome.

Public Country-by-Country Reporting

While companies analyze data needed for Pillar 2 compliance, many are also categorizing additional data they would like to obtain for impending public CbC reporting as—in the next few years—almost every large MNE will need to disclose country-level data in some form. The pressure is coming from around the world:

- The EU's public CbC reporting directive was approved in 2021 and comes into effect for calendar year companies in 2025, although some countries like Romania have already adopted it.
- Australia's public CbC reporting will apply to periods beginning on or after July 1, 2024.

Public CbC reporting requirements will typically mean that MNEs are required to disclose parts of the CbC reports they have submitting only to tax authorities for the last eight-plus years, now also to the public. However, corporate income tax data does not tell the entire story of an MNE's total tax contribution. MNEs are responsible for other significant types of taxes, such as indirect taxes, customs, payroll, real estate, and carbon taxes, to name a few. While most MNEs do not have this data easily arranged by country, many are asking whether now—while they work through their Pillar Two data gaps—is the right time to reconfigure systems, collect the data, and consider if it makes sense to report country's tax data that extends beyond corporate income tax to give a more complete picture of just how much tax they are contributing.

Volatile Interest Rates and Tightening of Regulatory Restrictions

2025 is poised to be an active year for transfer pricing issues for financial transactions. Companies will have to maintain an efficient capital structure while complying with new regulatory requirements from various countries around the world. Following the finalization of OECD Chapter X guidance, several countries have issued transfer pricing regulations for financial transactions. While the prior focus would have been on ensuring the arm's length nature of the interest rate, the current environment requires a more holistic approach towards intercompany financing transactions. For example, taxing authorities now question:

- Do the entities have the ability to obtain and service debt based on their own financial strength?
- How is the credit rating of the borrower impacted based on its relative position in the overall group? How should implicit support be considered?
- Is the financing structure primarily tax motivated and are the clauses in the intercompany agreement supportable?
- Is the company generating sufficient income to sustain the interest deduction?

A key concern is that companies are finding tax authorities are often not aligned on what the answers to those questions should be, raising the risk of tax controversy and potential double taxation. Also of importance is that due to regulations limiting interest deductibility, capacity to borrow, business purpose or arm's length interest rate are all necessary but not sufficient to ensure getting the full benefit of interest expenses in the absence of sufficient earnings.

While lowering of interest rates in the second half of 2024 (from its recent peak in 2022/2023) has provided a boost to capital markets activities, companies have to tackle a multi-dimensional challenge to avoid inefficiencies while funding their business and operational needs. Whether funding comes through intercompany loans, cash pooling arrangements or factoring (selling of receivable) transactions, the level of scrutiny (on overall structuring or pricing) is expected to be higher than it has been before. However, depending on a company's operating model, one form of financing may be better than others and such consideration and sensitivity analyses would be critical in identifying the best path forward. MNEs should also consider whether they have cash trapped in jurisdictions where outbound intercompany payments and cash repatriation are costly or otherwise impeded by foreign exchange controls, and look to restructure their operations accordingly.

Planning for Evolving Business Models

New technologies, such as artificial intelligence (AI) and clean energy technologies, are leading to transformations of business models in industries as disparate as the entertainment and automotive industries. In the field of medicine, emerging cell and gene therapies are leading not only to exciting new therapeutic breakthroughs but also to fundamental transformations of value chains. In addition, many MNEs are investing significantly in ESG—from developing new technologies to moving to greener suppliers to buying carbon credits. Some MNEs are moving into new ESG-related businesses, such as buying and selling carbon credits and considering if they should be burdening their business with an internal carbon price.

The evolution of business models is creating both opportunities and risks for companies. It is creating opportunities for rethinking transfer pricing structures to better align them to the new value chains while achieving greater tax efficiency. Conversely, the application of legacy transfer pricing models without regard to the fundamentally different value chains risks misalignment of value creation and transfer pricing outcomes, creating the potential for greater tax authority challenges. Companies should consider undertaking an analysis to understand changes in their value chains and determine appropriate changes to their transfer pricing structures going forward..

Transfer Pricing Controversy

Given that the tax authorities around the world are bolstering transfer pricing enforcement through increased staff and data analytics, companies should thoughtfully consider potential weaknesses in their positions and how they can strengthen transfer pricing documentation, background support for positions, or ways to get advance certainty (APAs). Recent court decisions and ongoing litigation serve as a reminder that companies should not rely on prior settlements, expired APAs, or audit history to protect against future adjustments. This shift in enforcement policy starkly underlines the importance of high-quality documentation for withstanding challenges.

Regulatory challenges remain a staple of transfer pricing litigation, with ongoing cases challenging intercompany financing arrangements, business restructurings, and the scope and value of intangible property transfers intercompany.

Now is a good time to consider APAs (including bi- or multilateral) to obtain certainty—especially if the intercompany transaction may be considered high risk, or the volume of the transaction is significant.

Year-end Adjustments

Where companies are struggling to perform their year-end adjustments correctly or need to make large adjustments at year-end, they should be exploring operational transfer pricing (OTP) solutions. OTP refers to the implementation of transfer pricing policies to effectuate or account for them in an organization's financial statements. It includes gathering and wrangling data to apply the policies, setting transfer prices, and monitoring and calculating adjustments. The increased scrutiny on transfer pricing results and the ever-changing tax regulatory landscape highlight the importance of strong OTP.

Making adjustments before year-end has become even more important given the treatment of transfer pricing adjustments under the Pillar Two Transitional CbC Safe Harbor. Transfer pricing adjustments made after the close of the year may not be taken into account in applying the Transitional CbC Safe Harbor, even if those adjustments are taken into account in determining the tax owed in a jurisdiction for the year, potentially leading to problematic mismatches.

Changing Transfer Pricing Compliance Requirements

Transfer pricing documentation requirements continued to evolve this year with many countries amending their documentation requirements to request more detailed information than previously. It is important to assess the impact on compliance for 2025 and future years. Stay up to date with these changes by checking into our Global Transfer Pricing Review .

Conclusion

There is a lot to consider in terms of international tax and transfer pricing as 2024 comes to a close. While we expect to see more changes in 2025, many of the key tax initiatives have progressed and this is a good time for MNEs to consider the impact for their business and how to address this.

Please reach out to one of your Meijburg & Co contacts if you need advice.
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