STPTAX

STREAMLINING YEAR-END TRANSFER PRICING ADJUSTMENTS FOR COMPLIANCE SUCCESS

DECEMBER 2024

1. Introduction

As multinational enterprises ("**MNEs**") approach the close of the financial year, it is crucial to ensure that transfer pricing ("**TP**") arrangements are aligned with business operations, tax compliance requirements, and the arm's length principle. Effective TP year-end adjustments ("**YEA**") can help mitigate risks related to cross-border tax issues, maintain accurate financial records, and position organizations for smooth fiscal transitions into the new year. The term YEA is used to describe adjustments made to the commercial accounts of relevant group companies, either just before or just after the year end, but (generally) before closing the books. Incorrect application of the group's TP policies could result in serious challenges made by tax authorities, potentially resulting in TP adjustments (and double taxation), interest and penalties. Therefore, it is important to periodically review your TP policies and adjust transfer prices (if necessary) in a timely manner.

This article aims to provide a general framework for YEAs, which includes general guidance on the practical aspects (i.e., analyzing, calculating, processing) of YEAs. This overview should not be interpreted as a tailored advice or a discussion of specific cases, which always require a case-by-case approach, analysis and substantiation. Moreover, this article does not consider any other tax implications than TP. For case-related questions on YEAs or other tax implications, the STP TP specialists are happy to assist you with their expertise.

2. Review existing TP arrangements

The end of the year presents an opportunity for MNEs with a December year-end to review and assess their current TP arrangements. This is essential for organizations that have experienced significant changes during the year or for those that need to ensure their pricing policies remain aligned with the business's evolving operations. It is important for MNEs to ensure that transfer prices reported in financial statements match the underlying business activities and financial outcomes for each jurisdiction in which they operate.

3. Analyze transactions and adjustments

One of the primary concerns during YEAs is addressing any discrepancies in the transfer prices. Specifically, MNEs should analyze transactions that have led to unexpected losses or unusual gains, even after applying the standard TP policy. Such results could indicate the need for a reassessment of pricing mechanisms, potentially signaling a gap between expected and actual results.

For example, transactions involving intercompany financing, such as loans, require careful review of accounting entries to ensure consistency with loan terms. This includes reviewing any financial covenant breaches, maturing loans, or adjusting arm's length interest rates. Similarly, MNEs that have made acquisitions during the year must re-examine the relevant TP policies, ensuring that financial data is accurately applied to the books.

In addition to these situations, companies that have recorded transfer prices based on budgeted financial data may need to 'true up' or 'true down' their accounts before year-end. This process is especially relevant when unexpected or exceptional costs have been incurred during the year, or when adjustments are needed to meet targeted margins for limited-risk distributors, assemblers, tollers, contract manufacturers, or service providers.

4. Addressing Tax Compliance and Customs Risks

When making year-end adjustments, MNEs should also be mindful of the impact these adjustments may have on their cross-border customs compliance. Changes in intercompany pricing can trigger unintended customs risks, such as increased tariffs or additional reporting requirements. It is therefore vital for MNEs to integrate their TP adjustments with their customs strategy, ensuring that all cross-border transactions are properly documented to prevent exposure to double taxation or customs penalties.

5. Consider New Developments in TP

5.1 Pillar One – Amount B

Under the OECD's Pillar One framework, the introduction of Amount B aims to simplify and streamline the application of the arm's length principle for baseline marketing and distribution activities. While this adjustment may affect how distributors calculate returns in jurisdictions that choose to adopt Amount B, existing documentation practices largely remain unchanged. However, companies with distributors in non-Amount B jurisdictions will need to implement dual analyses to meet both traditional TP and Amount B requirements.

To prepare for this adjustment, MNEs should assess whether any distributors within their operations fall under Amount B's scope. This includes conducting modelling to understand the impact on their existing TP arrangements and ensuring that distributors are appropriately included or excluded based on their industry and position in the Amount B pricing matrix. Companies should also review the accuracy of their balance sheet data, particularly when segmenting data related to distribution activities.

5.1.1 Pillar One – Amount B – the Netherlands

On 4 December 2024, the Dutch Deputy Minister of Finance published a new Decree on OECD Pillar One – Amount B. The Decree states that Amount B will not apply to baseline marketing and distribution activities in the Netherlands. However, the Netherlands commits to accepting the outcome of applying Amount B to baseline marketing and distribution activities in covered jurisdictions. The list of covered jurisdictions is published and maintained by the OECD. The Netherlands will provide a corresponding adjustment to transfer prices in order to prevent double taxation if:

A. The covered jurisdiction has implemented Amount B in local laws and regulations;
B. The covered jurisdiction has correctly applied Amount B; and
C. The covered jurisdiction has a bilateral tax treaty with the Netherlands.

5.2 Pillar Two – Global Minimum Tax

The implementation of Pillar Two, which introduces a global minimum tax set at 15%, has profound implications for MNEs that exceed the EUR 750 million revenue threshold. Companies operating across multiple jurisdictions will need to evaluate the impact of this new tax framework, including preparing for the new financial statement disclosures and compliance obligations that will come into effect as part of Pillar Two.

It is essential for MNEs to understand the implications of this global minimum tax, assess data gaps early, and budget for the complexities of multi-jurisdictional reporting. The intricacy of Pillar Two's calculations, which involve gathering extensive data from multiple countries, may require MNEs to adopt automation tools to streamline the process and ensure compliance.

5.3 Ensure Compliance with local TP laws

Beyond international tax frameworks like Pillar One and Pillar Two, it is important for MNEs to ensure that their TP adjustments comply with local tax regulations, which may vary from country to country. In some cases (if a timely YEA has not been made), this is solely corrected for tax purposes. In some European jurisdictions, tax authorities closely scrutinize these corrections to prevent profit shifting and ensure that tax obligations are met. In the Netherlands for example, it is not possible to make TP corrections resulting in a lower taxable amount (downward adjustment), in the Corporate Income Tax return, when the company cannot substantiate that the other jurisdiction includes a (taxable) corresponding upward correction. These mismatches are eliminated by a denial of the downward correction of the taxable income at the level of the Dutch entity.

In addition, in some countries, tax authorities may look more closely at adjustments involving government subsidies, particularly if a company has received tax relief or credits linked to subsidies for activities like clean energy, manufacturing, or research and development. This also applies to cases where businesses received COVID-19 relief measures, with tax authorities examining the proper accounting treatment of these benefits.

5.4 Strategic Use of Operational Transfer Pricing ("OTP") Solutions

MNEs that require significant YEAs should consider implementing OTP solutions. OTP is a set of tools and processes designed to integrate TP policies into an organization's operational framework. This includes applying pricing policies in the financial statements, gathering and organizing relevant data, setting transfer prices, and continuously monitoring and calculating adjustments. By employing OTP solutions, MNEs can reduce the risk of errors in their YEAs and increase the accuracy of their TP documentation.

5.5 Proactive Planning for 2025

While reviewing and adjusting year-end TP arrangements, it is also essential for MNEs to plan for the upcoming year. Setting clear financial goals, drafting a realistic budget, and reviewing tax strategies for the 2025 financial year will help mitigate potential TP risks and support business objectives. A structured approach to both the current YEAs and future planning ensures long-term tax compliance, operational efficiency, and effective risk management.

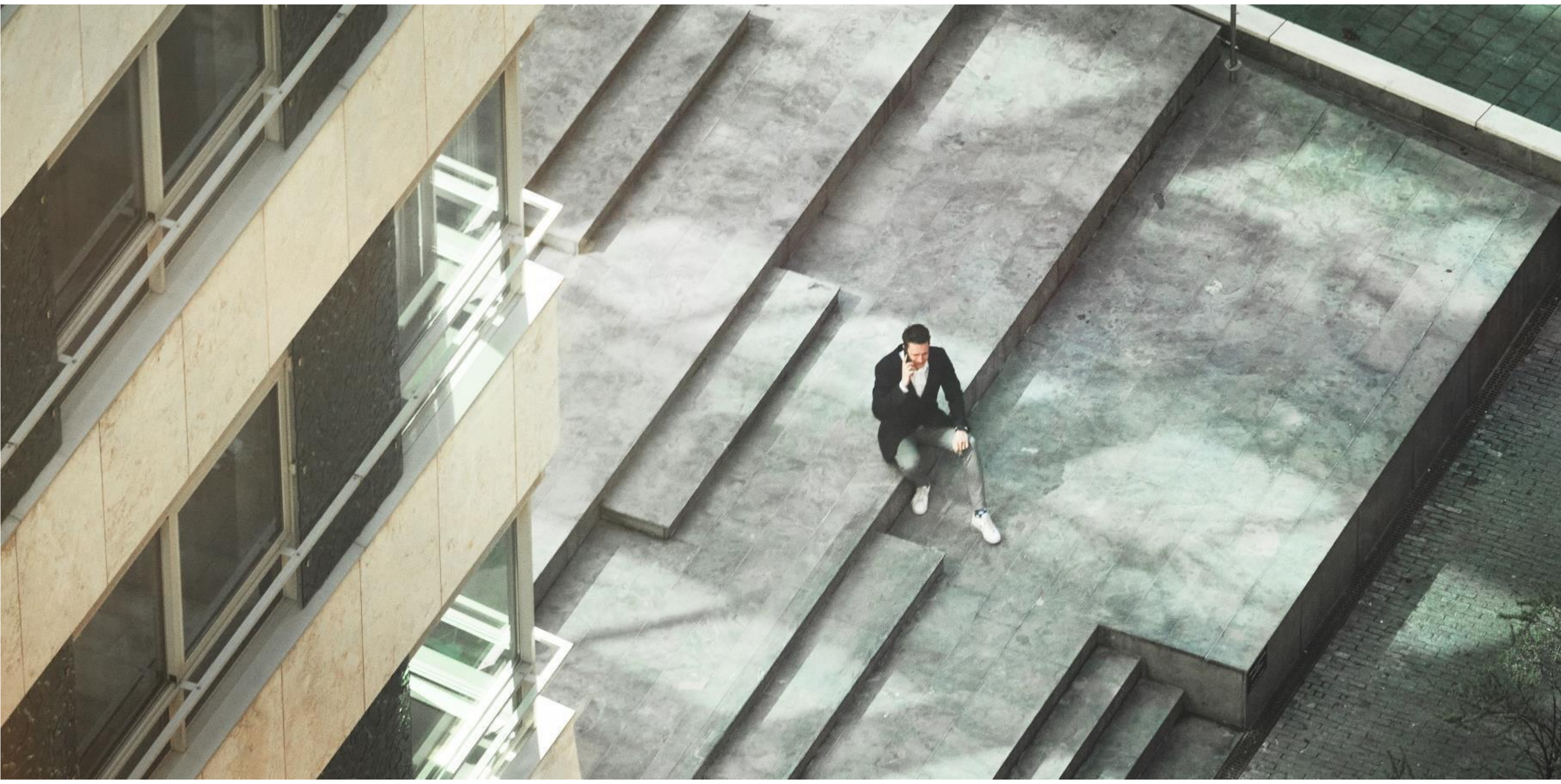
6. Conclusion

The end of the financial year presents an important opportunity for MNEs to review and adjust their TP arrangements. By conducting a thorough review of financial statements, intercompany transactions, and internal pricing policies, companies can avoid costly compliance errors, ensure alignment with business operations, and effectively navigate the complexities of global tax laws. With careful planning and the use of strategic solutions such as OTP, companies can ensure that they enter 2025 with accurate records and a clear tax strategy.

7. Key takeaway

This article shows that a correct application of the group's TP policy is imperative, as a deviation from your TP policy could lead to serious challenges made by tax authorities (TP adjustments (resulting in double taxation), interest and penalties). In order to correctly and consistently apply your TP policy, a well-structured periodical review process of the TP policy as well as the practical aspects as explained in this article is required. A key element of this process, in particular in the Netherlands, is timing: as in certain cases TP corrections can no longer be made and lead to double taxation. Companies should, therefore, timely and carefully review the extent to which YEAs should be made and make sure these are implemented in the financial accounts before closing the accounts.

Should you have any questions regarding the above (or TP in general), the STP TP specialists are of course happy to assist you with their expertise.



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