

Taxpayer-initiated Transfer Pricing adjustments

Depending on the given tax jurisdiction, if there is sufficient ownership or control between enterprises belonging to a Multi-National Enterprise ("MNE"), the arm's-length standard ("ALS") kicks-in to determine proper transfer prices in cross-border intra-group transactions.

Taxpayer-initiated transfer pricing adjustments (also known as compensating adjustments) are widely used by MNEs and are generally accepted by the tax authorities, provided that they are consistent with the results that would have been obtained if uncontrolled taxpayers had engaged in a comparable transaction under comparable circumstances.

In compensating adjustments, which are basically a reallocation of revenues or costs among enterprises, the following aspects should be considered:

TAX REPORTING OF ADJUSTMENTS

- Potential for transfer pricing enforcement activities in the affected countries.
- Is secondary transfer pricing adjustment required? Compensating adjustments (or lack thereof) could be regarded as deemed dividend subject to additional tax. Consider withholding tax liabilities.
- Do transfer pricing adjustments result in intra-group payments becoming non-deductible?

COUNTRY SPECIFIC RULES

- Some tax jurisdictions allow for or require compensating adjustments that seem beyond what the ALS justifies. Some others simply deny them.
- Is there any safe harbor rule on compensating adjustments in place?

TAX POLICY

- Has the transfer pricing policy concerning compensating adjustments been consistently applied over time?
- Are transfer pricing adjustments supported by intra-group agreements or transfer pricing documentation?

- Are company's accounts aligned with the outcomes of the corporate income tax return which embeds the adjustment?
- Is a compensating adjustment that complies with transfer pricing requirements aligned with the business perspective?

IMPACT ON OTHER TAXES

- When transfer prices are adjusted, the MNE needs to consider the effects on customs duties and potentially other indirect tax. It is important to become familiar with indirect tax or customs duties that may be owed.

While it is common to have such adjustments applied at year-end, taxpayers should consider implementing an interim monitoring of the transfer prices applied during the year (monthly, quarterly or semi-annual, depending on the case).

The above aspects should govern taxpayer-initiated adjustments and prevent future disputes with local tax authorities.

Do not hesitate to reach out to your local transfer pricing specialist for further assistance on the matter.

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