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Transfer Pricing and International Tax Year-End Considerations

by the Washington National Tax International and Transfer Pricing groups

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

- FDII, GILTI, and BEAT planning given expected rate changes
- 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
- Foreign tax redeterminations
- Corporate alternative minimum tax
- 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 expected tax rate changes after 2025 to both foreign derived intangible income (FDII) and base erosion and anti-abuse tax (BEAT), 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. At the same time, existing planning opportunities will continue to play a crucial role in year-end considerations.

FDII, GILTI, and BEAT Planning (Given Expected Rate Changes)

It seems likely that the benefits taxpayers obtain from FDII and the deduction for global intangible low-taxed income (GILTI) will decrease as the effective tax rate on FDII increases from 13.1 to 16.4 percent and the effective tax rate on GILTI increases from 10.5 to 13.1 percent after December 31, 2025. Companies may benefit from advancing post-2025 FDII or GILTI-related payments to 2025. Even in a steady-rate environment, having foreign affiliates make prepayments for FDII-eligible sales or services provided by the U.S. group may significantly increase the FDII deduction in situations where the U.S. group would otherwise have relatively modest annual FDII benefits due to offsetting cost of goods sold or expenses, as prepayments do not accelerate the offsetting expenses. Companies that are considering offshoring intellectual property should plan to do so in a way that maximizes the current FDII benefits. Notably, prepayments may be made in the form of cash or other property, including a note. The consideration of tax accounting methods is critical to this planning.

Barring action from Congress, the BEAT rate is scheduled to increase from 10 to 12.5 percent for tax years beginning after 2025. In addition, general business credits will no longer be usable to reduce BEAT liability. Transfer pricing techniques will, therefore, continue to be important tools to help companies manage their BEAT exposure, including to establish eligibility for the BEAT services cost method (SCM) exception under section 59A(d)(5).[1] In addition, companies should consider tax accounting methods that may reduce exposure or change the character of payments that would otherwise be base erosion payments, such as capitalizing payments to foreign related parties. Companies that make significant outbound payments to foreign affiliates should consider restructuring their operations if BEAT liability can no longer be avoided.

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 know which countries 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.

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.

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[1] Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

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 U.S. 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.
- The Financial Accounting Standards Board (FASB) issued accounting standards that require companies to provide a detailed breakdown of the income taxes they pay globally, effective for public companies for fiscal years beginning after December 15, 2024, and all other companies beginning December 15, 2025.

Public CbC reporting requirements will typically mean that MNEs are required to disclose parts of the CbC reports they have been attaching to their tax returns for the last eight-plus years. 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 regulation limiting interest deductibility (for example, section 163(j) in the United States, interest limitation rules in Ireland, and new transfer pricing rules in Australia) 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, overall BEAT position, or planning around Amount B, 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 IRS is bolstering transfer pricing enforcement through increased staff and data analytics, companies should thoughtfully consider potential weaknesses in their positions and how they can bolster 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 IRS agreements, or audit history to protect against future adjustments.

Regulatory challenges remain a staple of transfer pricing litigation, with ongoing cases challenging the validity of regulations concerning blocked income, stock-based compensation (in both the cost sharing and services contexts), and the scope of intangible property transferred pursuant to a cost sharing arrangement. What changed in 2024 was the framework for consideration of these challenges. In *Loper Bright Enterprises v. Raimondo*, the Supreme Court discarded the long-standing *Chevron* framework, which had provided for deference to agency regulations in many contexts: under *Chevron*, if Congress had not addressed the precise question at issue, an agency only had to come up with a "reasonable" interpretation, not the right one.

After *Loper*, it is up to courts to determine the right way to interpret a statute, and no amount of reasonableness will help an agency if the court disagrees. Yet in the tax space, and especially in the context of section 482, *Loper* may be less of a watershed than it is elsewhere: even under the *Loper* framework, agency interpretations continue to receive deference if Congress clearly delegated interpretive authority to the agency. Section 482's text contains a broad grant of enforcement power—whether that language, or the background regulatory authorization in 7805, also contains a grant of rulemaking authority in the transfer pricing space is something that courts will have to come to terms with as the next round of transfer pricing litigation advances. Even if taxpayers prevail in regulation challenges, they should beware of celebrating too soon: the *Liberty Global* saga shows how the IRS can use broad anti-avoidance rules and common law doctrines as alternative arguments.

Other ongoing cases involve the application of the acquisition price method for valuing platform contributions, the interaction of section 482 and the economic substance doctrine, CUT/CPM method disputes, and pricing for procurement services. A common—and surprising—through-line is the presence of transfer pricing penalties. While the last decade has seen its fair share of landmark transfer pricing cases, penalties were off the table in almost all of them. Not so with the cases now working their way through the courts: the IRS's efforts over the last seven or so years to ramp up penalty enforcement and scrutiny of transfer pricing documentation has made penalty application all but guaranteed in litigated cases, even when the taxpayer has contemporaneous documentation. This shift in enforcement policy starkly underlines the importance of high-quality documentation for withstanding challenges.

We are also observing continuing controversy outside the United States about transfer pricing issues. Now is a good time to consider APAs to obtain certainty—especially if the intercompany transaction may be considered high risk, or the volume of the transaction is significant. The ramifications of transfer pricing adjustments in subsequent years for Pillar Two purposes place an increasing premium on dispute prevention and up-front certainty.

The OECD's International Compliance Assurance Program ("ICAP") may be another avenue for companies to engage with tax authorities to obtain assurance about their transfer prices and practically reduce audit risks. The ICAP program, enables a company to potentially obtain assurance across multiple jurisdictions that its transfer prices are "low risk"; however, the risk assessments resulting from ICAP are not binding on tax authorities. ICAP participants have reported experiencing a "halo effect" for jurisdictions and years not covered by the ICAP process.

Foreign Tax Redeterminations

Taxpayers continue to see audit activity focused on transfer pricing, which often results in transfer pricing settlements that cause significant changes to the amount of foreign income taxes paid with respect to prior tax years. Such changes are very likely to result in foreign tax redeterminations and the attendant section 905(c) "notification" of the IRS via amended U.S. tax returns and reporting via Form 1118, Schedule L. While compliance with the notification requirements can be administratively costly, failure to properly notify the IRS of foreign tax redeterminations could result in missed U.S. federal income tax refunds, assessments of additional U.S. federal income tax, and penalties. KPMG is well positioned to help taxpayers with transfer pricing controversy, and the mitigation of the administrative burden and risks related to the section 905(c) notification requirements. In addition, taxpayers should be aware that in many cases, it is necessary to pursue mutual agreement procedure (MAP) relief with respect to foreign transfer pricing adjustments in order to obtain U.S. foreign tax credits (FTCs). Taxpayers will also have to consider how adjustments will impact calculations for Pillar Two purposes.

Corporate Alternative Minimum Tax

A new corporate alternative minimum tax (CAMT) was effective for tax years beginning in 2023. CAMT generally applies to certain large corporate taxpayers (i.e., those with over $1 billion adjusted book income) to the extent that 15 percent of a taxpayer's adjusted book income (less CAMT FTCs) is greater than the taxpayer's regular tax (less regular tax FTCs) plus BEAT. Although the tax base for CAMT is book income, many of the adjustments require applying tax concepts and unpacking consolidated financial statements to disaggregate transactions between taxpayers that are consolidated for book but not for tax. Moreover, CAMT liability is triggered by differences between adjusted book income and tax, which suggests that transfer pricing choices may be important for some clients.

Almost all corporations will be required to file the new Form 4626 for 2023, even corporations that are out of scope or have no CAMT liability. The only exception for 2023 is for corporations that meet the safe harbor, which generally reduces the applicability threshold to $500 million adjusted book income.

The government released a large package of proposed regulations in September 2024 and previously released a multitude of notices on CAMT. Most taxpayers do not need to revisit their 2023 tax return positions and may generally continue relying on the statute or some combination of statute and notice guidance for 2023 tax returns. However, fiscal year taxpayers with tax years ending after September 13, 2024, may need to consider certain provisions for their 2023-2024 tax years. Moreover, the preamble contemplates adjustment to adjusted book income in year of finalization to implement the final regulations if a taxpayer took a position under CAMT that is inconsistent with the final regulations. This may cause certain taxpayers to reconsider certain 2023 CAMT positions.

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.

Companies that are able to reflect year-end adjustments on their books for the year will avoid the necessity to make Schedule M book-tax adjustments after the books are closed and will likewise avoid the secondary adjustment consequences associated with such adjustments. 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 and it is important to assess the impact on compliance for 2025 and future years.

Brazil

Brazil’s new transfer pricing rules (that align Brazil mostly with the 2022 OECD Guidelines) were mandatory from January 1, 2024 - with transfer pricing documentation that will need to be submitted by the last business day of 2025 calendar year. Companies where the new transfer pricing regime will mean a significant change in 2024 to the overall profitability of operating in Brazil will need to carefully document the changes they have made and be able to show taxing authority they have appropriate governance procedures in place and that they are implementing the company’s transfer pricing policy appropriately. It is also important that companies have intercompany agreements underlying the updated transfer pricing.

United Kingdom

The UK’s HMRC introduced new transfer pricing documentation requirements for CbC report-sized groups, effective April 1, 2023. These include a Master File and Local File, as outlined in Annexes I and II of Chapter V of the 2022 OECD Transfer Pricing Guidelines. This marks a significant change, as the UK now has mandatory, prescriptive transfer pricing documentation requirements for the first time. Additionally, on September 10, 2024, HMRC published compliance guidelines for dealing with transfer pricing risks (GfC7). These guidelines provide a practical approach to managing risks associated with the setting, testing, and documenting of transfer prices. The guidelines are intended to help businesses understand which compliance approaches HMRC would see as being low and higher risk. The guidelines also emphasize the accountability of individuals within UK businesses, referred to as “UK risk leads,” for transfer pricing compliance, paving the way for more rigorous enforcement of penalties. See The Transfer Pricing Records Regulations are here!; Transfer Pricing Records Regulations 2023: mandatory requirements; and UK: Compliance guidelines for dealing with transfer pricing risks.

France

France’s Finance Act (FFA) 2024 has tightened transfer pricing documentation requirements. Effective January 1, 2024, companies with revenues or gross assets of €150 million (previously €400 million) must have full transfer pricing policy documentation available for tax authorities. From this date, adherence to the documentation policy is mandatory to avoid a presumption of indirect profit transfer. Additionally, noncompliance or partial responses to documentation requests will incur a minimum fine of €50,000, up from €10,000. See France: Tax-related provisions in finance law for 2024.

Malta

The Malta Tax and Customs Administration (MTCA) published guidelines mandating the preparation of a Master File and Local File in accordance with Chapter V of the OECD Transfer Pricing Guidelines effective January 1, 2024. This documentation should be kept and disclosed only upon request by the MTCA. See Malta: Transfer pricing guidelines.

Conclusion

There is a lot to consider in terms of international tax and transfer pricing as 2024 comes to a close and the 2025 year starts. While we expect to see more changes in 2025, many of the key tax initiatives have progressed such that now is a good time for MNEs to consider tax planning opportunities going forward.

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