

# Transfer pricing year-end adjustments

Depending on the given tax jurisdiction, if there is qualified ownership or control between enterprises belonging to a Multi-National Enterprise (“**MNE**”), the arm’s-length principle (“**ALP**”) kicks-in to determine proper transfer prices in cross-border intra-group transactions.

Compensating adjustments (also “year-end adjustments” or “**CAs**”) are widely used by MNEs in order to align intragroup transfer prices or margins to the results that would have been obtained if uncontrolled taxpayers had engaged in comparable transactions under comparable circumstances. CAs are generally accepted by tax Authorities, in particular when they are set according to a proper transfer pricing policy.

CAs, which are basically economic reallocations of revenues and/or costs among enterprises within an MNE, are often used in aligning the profitability of limited risk profile entities (LRDs, CMs, TMs, etc.). In particular, because these entities’ remuneration shall be tied to an arm’s length targeted net margin, when that is affected by internal or external factors, CAs would warrant alignment and consistency with the ALP.

A robust risk, asset and functional analysis – which should be constantly monitored to intercept any changes along the group’s structure – as fundamental step aimed at determining the arm’s length remuneration in intragroup transactions, shall be able to identify (amongst others):

- Where strategic decisions are taken and functions are undertaken within the group
- Where non-strategic activities (i.e. routine functions) are performed
- How potential losses/excess profits should be allocated within the group value chain
- Whether currency risk is correctly allocated among the parties to the intragroup transaction and the related impacts to transfer prices
- If a new benchmarking study is due to be consistent with the potential changes occurred in the business model

When CAs are applied, 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 ALP 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 CAs been consistently applied and documented 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, MNEs need to consider the effects on customs duties and potentially other indirect taxes. It is important to become familiar with indirect taxes 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 drive taxpayer compensating adjustments and help preventing 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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