



Insights: Transfer Pricing

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January 2022

Our consulting work: The year in review

The ripple effect of the pandemic continued to dominate economic conditions in 2021, with acute supply chain issues, inflation, and flux in the labor market. As transfer pricing practitioners advising clients across numerous industries, we have observed the imbalance of the recovery across different countries and sectors, market opportunities for resilient companies able to pivot and scale, and continued uncertainty. The net effect is a complex environment for transfer pricing as we try to match the economic impacts on tested parties with the impacts on comparable companies, model risk in the capital markets, and mirror transactional behavior. Against this backdrop, a new global tax architecture is taking shape that will impact large taxpayers.

In this *Insights*, you will learn about:

- CRA's broad and comprehensive global transfer pricing capabilities from documentation to planning
- Complexities and opportunities in benchmarking and planning
- Political momentum behind a global minimum tax
- International tax impacts of the Build Back Better Act
- EU Public Country-by-Country Reporting
- Taking control of transfer pricing in a highly complex regulatory environment

Our **consultants** help clients navigate every phase of implementing and supporting international tax structures, including: intangible property (IP) and acquisition planning, transfer pricing policy implementation, global documentation, and controversy. We also continue to be engaged to provide expert testimony in transfer pricing litigation. We highlight some of the work performed during 2021 below.

Global compliance documentation

Based on our extensive knowledge of global regulatory requirements gained through firsthand interactions with regulatory bodies across the world, CRA provided tailored documentation recommendations for each client. For example, some tax authorities require specific additional information to be included in the local file, have filing requirements, or demonstrate higher levels of scrutiny in practice. We advised clients on their global transfer pricing documentation obligations, kept them apprised of documentation requirements and assisted with Country-by-Country Reporting (CbCR) compliance, Local File and Master File development, as well as regional form submissions. CRA's comprehensive transfer pricing documentation provided robust defense during tax audits in numerous jurisdictions, helping to reduce audit duration and assessments.

Benchmarking

Benchmarking continues to be at the core of many transfer pricing analyses, whether in the context of planning, documentation, or tax controversy. CRA subscribes to global databases that are also used by tax authorities in many countries. Using these databases, CRA continues to support clients with global documentation and local country audits. Benchmarks include transactional data, royalties, profit-based ratios, interest rates, as well as capital market observations. CRA benchmarked many types of intercompany transactions in 2021, such as:

- asset management fee benchmarks;
- distributor and retailer profitability;
- manufacturer returns;
- profits earned across numerous strategic, value-added, and low-value services;
- interest rates on loans;
- cost of capital;
- royalty rates for IP; and
- risk-adjusted returns on a variety of asset types.

Given the fluctuations we have seen over the last year in returns in certain sectors, CRA implemented industry- and country-specific adjustments that have not been required in the past to increase the reliability of the results. Examples include (1) COVID-19 impact on apparel retailers which left companies with extraordinary expenses related to store closures and obsolete inventory, (2) the impact on financial results from various economic stimulus programs, and (3) the impact of local market conditions and regulations on different segments of the healthcare industry. We have observed that every company has its own unique pandemic story. Transfer pricing policies adopted pre-pandemic should be reevaluated to ascertain whether they continue to reflect current economic conditions and ultimately remain reliable.

Intercompany loans continue to be a hot topic in light of the recent Organisation for Economic Co-operation and Development (OECD) guidance. CRA has benchmarked arm's-length interest rates by determining standalone credit ratings and relying on comparable bond yields specific to the terms of the intercompany loan agreements including term, size, covenants, guarantees, and currency. For example, to maintain compliance with an overall tax strategy, CRA designed and implemented tranching of an aggregate intercompany loan to a distressed borrower by modeling optimized 10-year tranches via a cash flow analysis to determine debt serviceability of each tranche.

Global planning

The pandemic has triggered changes in business models due to the mass adoption of remote working and supply chain issues. In light of the increase in employee mobility, we have designed and implemented global services profit split models for professional services companies to better align transfer pricing outcomes to the new realities of where value is created. These models are well suited to the current fluidity in the labor market and allow companies to add talent and resources in any jurisdiction without undermining the transfer pricing policy. Certain clients faced with acute supply chain issues are exploring strategies of reshoring or nearshoring manufacturing to improve supply chain time and cost metrics and to avoid tariffs in escalating trade wars. These analyses have required a detailed understanding of the redesigned supply chains and competitive advantages in the context of the business restructuring guidelines.

Intangible assets represent an ever-increasing proportion of corporate value, continue to be key levers in tax planning, and are the subject of many tax disputes. We have been engaged to value novel technologies in emerging fields (including cryptocurrencies), as well as platform intangibles in mature industries in planning and controversy settings. Based on the facts and circumstances, and as permitted by the guidelines, we have valued intangibles using the income, market, and cost approaches, often using two approaches to corroborate values and provide support for measuring uncertain tax positions. Key issues that have arisen during our analyses have included: cost of capital, the robustness of assumptions underpinning financial forecasts, competitive entry into the market, development pathways and probabilities of success, net working capital considerations relating to deferred revenue and transfers of inventory, and the opportunity cost of capital investments required to commercially exploit the intangibles.

The mergers and acquisitions market continued to be active during 2021 with both strategic and financial acquirers pursuing and executing deals. Our work has spanned buy-side and sell-side, with an emphasis on risk mitigation and tax efficiency. We have analyzed acquirers' combined and targets' standalone financial projections to isolate the value of synergies for transfer pricing purposes. CRA has assisted sell-side growth-stage clients to identify uncertain tax positions, implement transfer pricing policies, and prepare global documentation to preemptively address issues in due diligence.

In the face of continued controversy, potential changes to global tax principles, and increased transparency, taxpayers are reexamining their transfer pricing policies and outcomes. CRA has performed profit allocation analyses in the context of dispute resolution and planning around the realignment of IP, economic substance, and profitability. Based on our experience resolving disputes, a principled profit split analysis to support the outcome of a one-sided transfer pricing policy can be used to identify and mitigate risks in other planning circumstances.

Global tax in the headlines

Broad international endorsement of a global minimum tax of 15% made front page news in 2021. The OECD brokered a consensus agreement on the major threshold points of Pillar One and Pillar Two, but many of the details are yet to be ironed out and implementation hurdles remain. We now know that the Biden administration's suggestion to broaden the industries in scope while limiting the overall number of corporations subject to Pillar One prevailed even though this represents a departure from the original intention to focus on tax issues arising from digital business models. The Inclusive Framework limits the new taxing right to the super profits of multinational enterprises with revenues in excess of €20 billion, with exclusions limited to the extractive industries and regulated financial services. Specifically, Amount A of Pillar One will reallocate 25% of accounting profit before tax in excess of 10% of net revenue to market jurisdictions. Pillar Two will seek to impose a global minimum tax on accounting profits of 15% for all multinational enterprises with revenues greater than €750 million in at least two of the four fiscal years immediately preceding the tested fiscal year. The G7 Leaders' communique endorses the scope and thresholds of Pillar One and Pillar Two and urges the OECD to deliver the technical implementation plan as soon as possible for a 2023 effective date. While Pillar One and Pillar Two increase the effective tax rate of many in-scope corporations, tech companies subject to current or pending digital services taxes will benefit from increased certainty and a level playing field. Failure to implement the OECD proposals will likely lead to increased unilateral action targeted at tech companies, many of which are US companies.

Do Pillar One and Two apply to you?

- Pillar One: Applies to certain companies with €20 billion or more in revenue
- Pillar Two: Applied to certain companies with €750 million or more in revenue

The Build Back Better Act (BBBA) was passed by Congress in November 2021, however negotiations in the Senate have stalled (as of early January 2022). Moderate Democrats have insisted that BBBA be paid for via tax measures. While numerous international tax proposals have been discussed, the ones that made it into the House version of BBBA are changing the global intangible low-taxed income (GILTI) regime to a country-by-country approach (which will make GILTI a Pillar Two-compliant regime) and increasing effective tax rates for profits subject to GILTI and the foreign-derived intangible income (FDII) regime. The House version of BBBA also includes an alternative minimum tax for corporations of 15% of accounting profit. Proposed section 163(n) turns a spotlight on external and intercompany financing by imposing a limitation on interest deductibility for certain US corporations. Planning for 163(n) will require proportionately aligning interest expense with EBITDA and potentially borrowing externally at the subsidiary level, with parent company loan guarantees. The interconnectedness of GILTI and Pillar Two means that failure to pass the BBBA may jeopardize the OECD's multilateral efforts.

Tax transparency continues to gather momentum with the EU Parliament passing a directive to require public reporting of country-by-country taxes paid and other financial and operating metrics in each EU country and jurisdictions on the EU grey and black lists. This new reporting is expected to take effect in 2024 and will apply to multinationals operating in the EU, regardless of where they are headquartered, with annual revenues in excess of €750 million.

Questions to assess transfer pricing readiness

- Was your business significantly impacted by COVID-19?
- Was there a business/operational restructuring?
- Is your transfer pricing policy tax-efficient?
- Do you have appropriate documentation and intercompany agreements in place for compliance?
- Do you have a streamlined process to ensure the implementation of transfer pricing policy each year?

Let's talk

As tax authorities continue to scrutinize documentation reports, the need for well-delineated contemporaneous documentation submission/preparation will increase. Denmark joined a list of countries that require a mandatory filing of the transfer pricing documentation starting in 2021. Australia, Mexico, and the UK have significantly increased the level of detail required in the tax return filing related to intercompany transactions over the last few years. In this highly complex regulatory environment, a proactive approach to evaluating the level of transfer pricing compliance is not only encouraged but crucial to avoid penalties and audit adjustments. Our consultants can provide a customized, contemporaneous documentation package that is tailored to each company's multinational operations by performing a risk/benefit assessment and reviewing all intercompany transactions in place, including intercompany loans, cross charges, and business restructurings. Contact us to start a conversation around planning and get a customized proposal for a package of compliant documentation files.

For more information about this edition of *Insights: Transfer Pricing*, and our services, contact:
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