International Tax & Transfer Pricing Update

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Transfer Pricing: Current Events & Customs

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Agenda

1. What is TP?
2. TP Risk Management Best Practices
3. Customs and Transfer Pricing: Rules and Regulations
4. Customs and Transfer Pricing: Common Pitfalls and Potential Solutions

What is Transfer Pricing?

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The practice of setting a price for the transfer of anything of value exchanged between two or more related entities

- How to define "related entities"? Percentage ownership or control?
- Services, Intangibles, Tangible Goods, Financial Products, etc.
- Important because transfer prices impact taxable income

Transfer pricing rules/regulations throughout the world are based on the *arm's length standard*

Applies to business groups with legal entities or personnel in multiple tax jurisdictions/regimes

- Generally multinational enterprises
- Organizations with both non-profit and for-profit business and other exceptions

Risk Management Best Practices

Key Categories of Risk

- Income tax risk
- Competitive [dis]advantage risk

Best Practices

- Plan
- Document
- Defend

Customs and Transfer Pricing: Rules and Regulations

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Transfer pricing: tax authority

OECD Guidelines / IRC Section 482-3

- Transactional Methods
- Profits-based Methods

Customs: agency, maybe tax authority

Extensive set of rules and processes to import goods

- Duties levied on some items based on transactional value (TV)
- For MNE's this is generally the transfer price
- WTO Agreement establishes TV as primary method of valuing imported goods (in a listed hierarchy of alternative methods), if parties demonstrate relationship did not influence the price.

Customs and Transfer Pricing: Common Issues

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Typical Fact Pattern

TPM is CPM/TNMM (Profits-based Method): -> planning and, in most cases, adjustments

Pricing of goods set to achieve target margin based on assumptions:

- Market prices
- Inventory obsolescence
- Warehousing and logistics expenses
- Selling expenses
- Foreign exchange fluctuations
- Warranties and returns

Variability in these factors generally requires changes to the pricing of imported goods to ensure yearend financial results align with arm's length standard

Pitfall #1 – "Set it and forget it"

Pitfall #2 – No provisions for adjustments in legal agreement

Pitfall #3 – Transfer prices omit IP value paid through separate royalty

Customs and Transfer Pricing: Common Issues

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Pitfall #1: Set it and Forget It

Pain Points:

- Adjustment required to avoid non-arm's length financial results
- Need to redo customs declarations for the entire year (PAINFUL and COSTLY – customs filings and maybe duties too)

Solutions:

- Manage and modify pricing of goods on periodic basis based on YTD results and rest-of-year projections
- Important that this be done periodically in order that transaction value reflects market value and to avoid a potentially lengthy process to recoup duties
- Market support fee
- Production management contribution fee

Customs and Transfer Pricing: Common Pitfall #2

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Pitfall #2: No Adjustment Provisions in Legal Agreement

Pain Points:

- Some jurisdictions require legal agreements with detailed terms to make payments to affiliates
- Including price list <u>without</u> a provision to adjust pricing limits flexibility to adjust prices, resulting potentially in non-arm's length pricing + inaccurate customs declarations

Solution:

- Thoughtful preparation of intercompany agreements that provide flexibility for adjustments by specifying a process whereby testing of pricing is required and adjustments, when appropriate, are compulsory

Customs and Transfer Pricing: Common Pitfall #3

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Pitfall #3: Transfer Price Omits IP Value, Royalty Paid Separately

Pain Points:

- Transactional value does not include royalty -> inaccurate customs filings
- Creates extra withholding tax on the royalty payment
- IRS inbound distributor campaign emphasizes IRS intention to take initial position to disallow royalty; OECD Guidelines advocate IP value be embedded in good price

Solution: Include royalty component in the price of the goods

- Incorporate IP value into the price paid for the good: may require a change in TP method
  - ↑ compliance w little/no impact on amount duties because many imported goods do not attract (large) duties
- Do not forget Pitfalls #1 and #2 – for this solution to work, legal agreements must reflect imbedded IP and include adjustment mechanisms


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2024 US Tax Outlook

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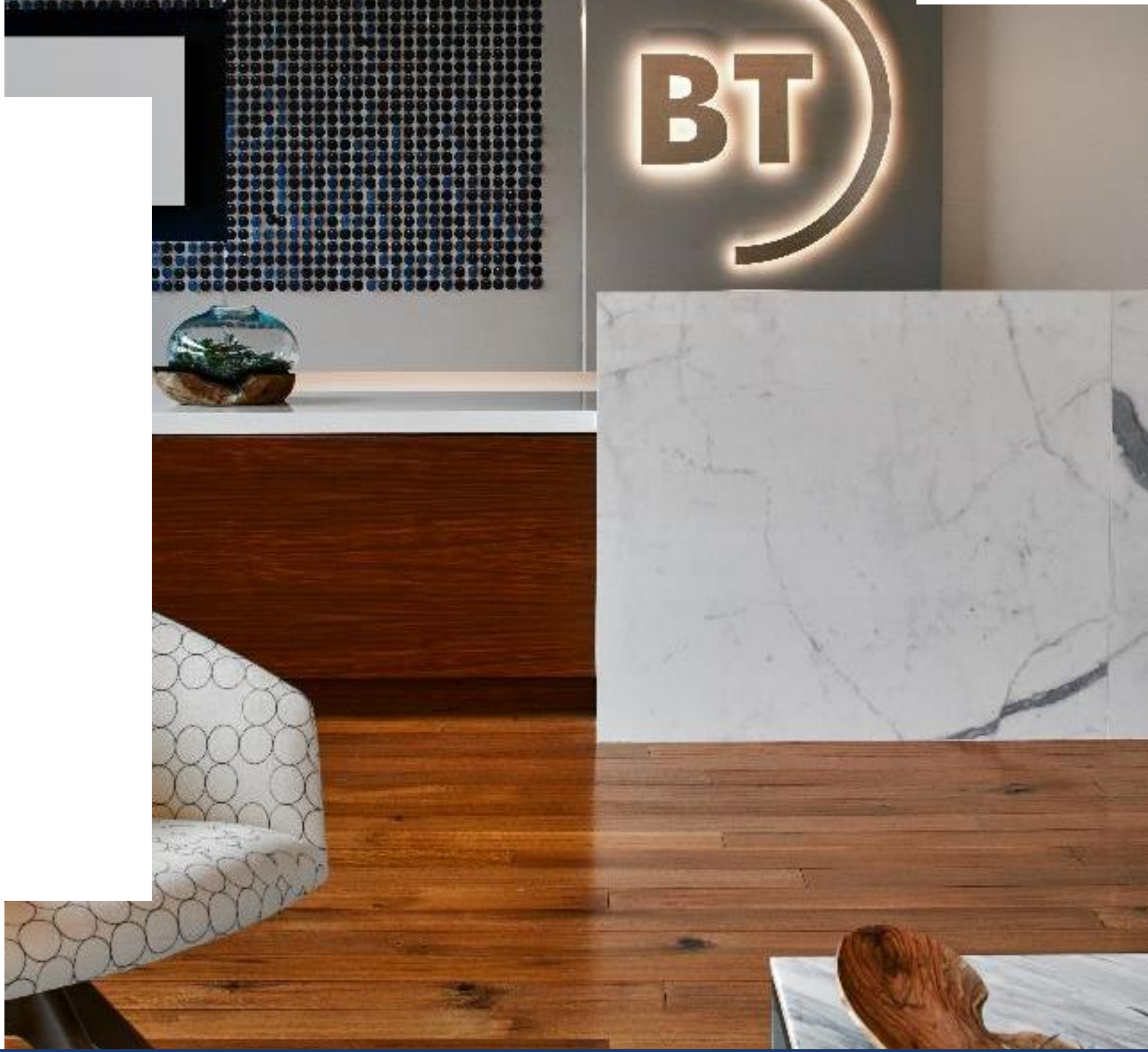
Agenda

1. Corporate Transparence Act/Beneficial Ownership Reporting
2. TCJA Temporary Provisions
3. Bipartisan Tax Bill
4. Presidential Candidate Comparisons



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CTA/BOI Background

United States now will require certain legal entities to report to the federal government identifying information about the individuals who directly or indirectly own or control a company within the scope of the new legislation. This information will be housed in a centralized, secure nonpublic federal government database to be administered by the Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Department of the Treasury.

Requires certain entities, including corporations, LLCs and other similar entities to report identifying information about the individuals who directly or indirectly own or control a company within the scope of the legislation unless the entity is out of scope or an exception applies.

Reporting Company Created Prior to January 1, 2024

- Company Information
- Beneficial Owners

Reporting Company Created After January 1, 2024

- Company Information
- Beneficial Owners
- Company Applicants

TJCA Provision Sunset

- The Tax Cuts and Jobs Act moved through a Republican-controlled Congress in 2017 under budget reconciliation rules which means that the bulk of the provisions on the individual side of the code (including for passthrough entities) are in effect only through 2025.

- Other notable TCJA provisions that are scheduled to sunset after 2025 include the higher deduction percentages for global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII), the limitation of the deduction for state and local taxes (SALT), and the repeal of the personal exemption.

- The future of the TCJA tax cuts is likely to frame much of the tax policy debate ahead of the presidential and congressional elections this November. Republican candidates likely will push for long-term—or even permanent—extensions of the expiring provisions. Democratic candidates, meanwhile, are likely to contend that the TCJA's tax benefits should be extended only for less affluent taxpayers (such as those with incomes below $400,000, the threshold often cited by the Biden administration) or be allowed to lapse.

R&D Capitalization

DELAY THROUGH 2025 MANDATORY CAPITALIZATION OF RESEARCH EXPENDITURES UNDER SECTION 174—FOR DOMESTIC EXPENDITURES ONLY—RETROACTIVE TO EXPENSES PAID OR INCURRED IN TAX YEARS BEGINNING AFTER DECEMBER 31, 2021

LIMITING THE TAX BREAK TO DOMESTIC R&D IS A DISAPPOINTMENT TO INDUSTRIES WITH LARGE FOREIGN ACTIVITIES LIKE PHARMACEUTICALS.

Bonus Depreciation

REINSTATE 100 PERCENT BONUS DEPRECIATION THROUGH 2025, FOR QUALIFIED PROPERTY PLACED IN SERVICE AFTER DECEMBER 31, 2022;

REINSTATE THROUGH 2025 THE ALLOWANCE FOR DEPRECIATION AND AMORTIZATION FOR THE 30 PERCENT LIMITATION ON INTEREST DEDUCTIONS, RETROACTIVE TO TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 2023, AND, IF ELECTED BY THE TAXPAYER, RETROACTIVE TO TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 2021

Other Provisions

ALLEVIATE DOUBLE TAXATION BURDENS ON TAIWANESE COMPANIES OPERATING IN THE UNITED STATES,

INCREASE THE SMALL BUSINESS EXPENSING LIMIT AND INDEX IT FOR INFLATION,

INCREASE THE DOLLAR THRESHOLD THAT TRIGGERS CERTAIN INFORMATION REPORTING REQUIREMENTS FOR PAYMENTS BY A BUSINESS FOR SERVICES PERFORMED BY AN INDEPENDENT CONTRACTOR OR SUBCONTRACTOR.

Other Updates

- Treasury issued proposed regulations in 2019 to determine how the income from cloud computing transactions or transactions involving digital media would be classified for tax purposes under Section 861. Cloud computing allows customers to use remote internet servers to manage, process, and store data. Treasury is considering issuing a companion notice of proposed rulemaking to the final regulations addressing the issue of sourcing.

- Delay of the requirement for persons engaged in a trade or businesses to report information related to the receipt of digital assets on IRS Form 8300, Report of Cash Payments Over 10,000 Received in a Trade or Business. Have had several clients looking to invest into US businesses using cryptocurrency and other nontraditional methods.

- Corporate Alternative Minimum Tax and “Undertaxed profits rule”

President Biden

- Increase the corporate income tax rate to 28 percent.
- Increase the global intangible low-taxed income (GILTI) tax rate from 10.5 percent to 21 percent and repeal the reduced tax rate on foreign-derived intangible income (FDII). Read more.
- Repeal the base erosion and anti-abuse tax (BEAT) and replace it with an undertaxed profits rule (UTPR) consistent with the OECD/G20 global minimum tax model rules.
- Expand the net investment income tax to nonpassive business income

President Trump

- Maintain the 21 percent corporate income tax rate from the 2017 Tax Cuts and Jobs Act

President Biden

- Tax long-term capital gains and qualified dividends at ordinary income tax rates for taxable income above $1 million and tax unrealized capital gains at death above a $5 million exemption ($10 million for joint filers).

- Tax carried interest as ordinary income.

- Impose a minimum effective tax rate of 20 percent on an expanded measure of income including unrealized capital gains for households with net wealth above $100 million.

President Trump

- No Change


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International / EU tax developments

DUBLIN (JANUARY 24, 2024)

EDGAR VAN HASSEL

EU Tax landscape

Ambitious EU tax agenda of which first steps are implemented in 2024.

Highlights further evolution from a national to a pan-European landscape.

The increase of positive EU direct tax law is expected to continue and to have effect on more than we think…

Table of contents

Transfer pricing

EU TP directive: proposal for a council directive on transfer pricing

Introduction

a. Proposal Date: September 12, 2023
b. Aims to integrate key Transfer Pricing (TP) principles into EU law and to ensure a common application of the arm's length principle in the EU.
c. Timing: application by member states as of January 1, 2026.

Transfer pricing

Key Elements

a. Associated enterprises: based on management position and significant influence or voting rights, profit rights or ownership rights of **more than 25%.**
b. Fast-track (**180 days**) procedure for resolving double taxation
c. Downward adjustments allowed under certain conditions (inclusion in tax base and disclosed in another jurisdiction)
d. Prescription of the most appropriate TP method from **OECD TP Guidelines**
e. Use of interquartile range prescribed and option of States to adjust to median if results fall outside the range (**going beyond OECD guidelines in many EU Member States**)
f. Requirement for sufficient TP documentation (to be determined in more detail later)

EU developments

BEFIT proposal: proposal for a common corporate income tax framework for groups active in the EU.

Introduction

a. Proposal Date: September 12, 2023
b. Uncertainty regarding implementation in proposed form
c. Timing: implementation by Member States as per January 1, 2028 with application as per 1 July 2028.

EU developments

Key elements (1/3)

a. BEFIT group: based on **75% ownership** or profit rights requirement.
b. Scope: Mandatory for EU headquarters with annual combined revenues above EUR 750 million.
c. Mandatory for non-EU headquarters if EU part has at least EUR 50 million in annual revenues or accounts for at least 5% of total group revenue.
d. **Option** for groups below thresholds to opt into BEFIT for at least a five-year period, provided they prepare consolidated financial statements.
e. Tax base: based on financial accounting net income, with specific adjustments…

EU developments

Key elements (2/3)

a. **Aggregation and allocation**
b. Aggregation of preliminary tax results of all BEFIT group members.
c. Allocation of aggregated group tax base to group members using a seven-year transitional allocation rule. Allocation based on each member's weighted share in the aggregated tax base in the previous three fiscal years.

EU developments

Key elements (3/3)

a. Member States may apply deductions, tax incentives, or base increases to their allocated parts.
b. BEFIT contains advantages such as cross-border loss relief and no withholding tax on intra-BEFIT group interest and royalty payments.
c. MNEs can have both BEFIT filing obligations **as well as** local corporate income tax filing obligations for entities that do not meet the 75% ownership threshold.

EU developments

Proposal for **Head-office tax system** for *micro, small and medium-sized enterprises* (as part of BEFIT package)

a. September 12, 2023;
b. The proposed Directive provides micro, small and medium-sized enterprises (SMEs) at the initial stages of expansion with an option to compute the taxable result of their permanent establishments (PEs) in other Member States, on the basis of the rules of the Member State where the Head Office (i.e., headquarters of the SME) is resident for tax purposes.
c. File only one Tax Return;
d. Member States will share the return with the other States;

e. → all Member States will be allowed to do a Tax Audit!

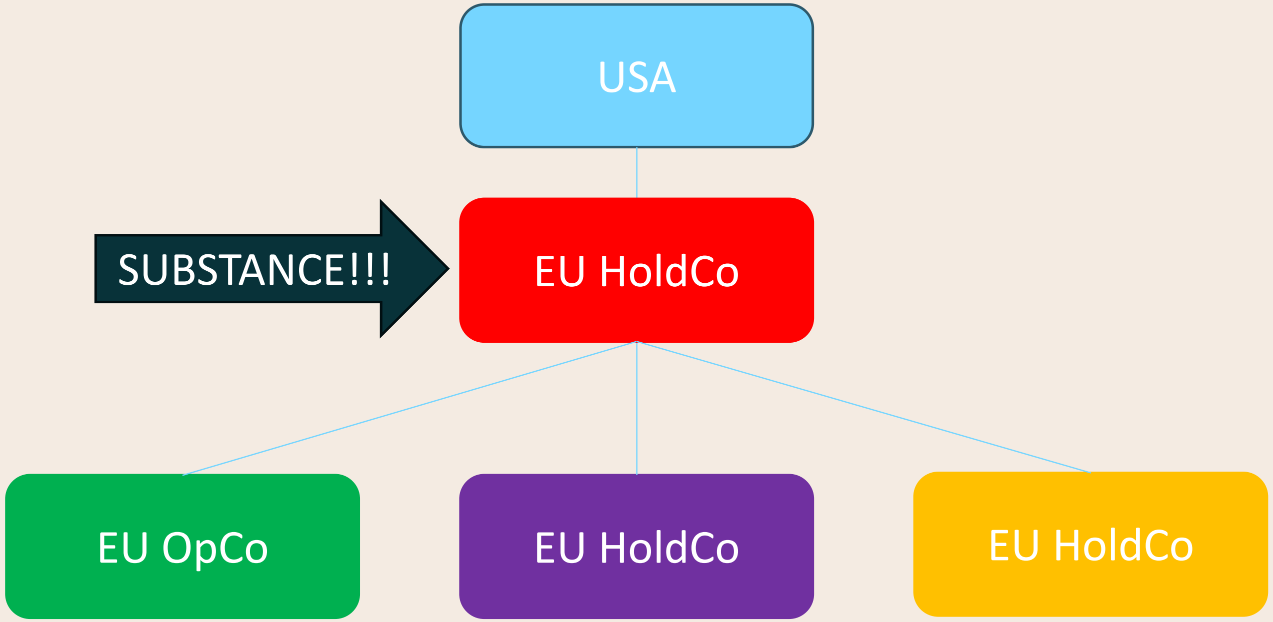
EU developments

Unshell proposal (ATAD 3)

a. Ongoing discussions
b. Compromise on substance indicators and tax consequences challenging
c. New approach considered in November 2023
    i. Substance requirements as a minimum standard, allowing Member States to add additional criteria
    ii. Entities failing to meet additional criteria **presumed as shell entities**
d. European Commission's 2024 Work Program emphasizes the imperative for an agreement on the Unshell proposal…

EU developments

Unshell proposal (ATAD 3) – structures “under scope”



→ Without *sufficient substance* HoldCo will be “ignored”….

EU developments

FASTER Proposal; Harmonizing withholding tax relief

Introduction

a. Aims unified framework for withholding tax relief procedures for dividends and interest;
b. Timing: if adopted, implementation as per 1 January 2027

- The FASTER proposal consists of four components:

  - Quick relief systems
  - National registers for Certified Financial Intermediaries (‘CFIs’).
  - Standardized Reporting Obligations
  - Common EU Digital **Tax Residence Certificate** (‘eTRC’)

EU developments

Environmental, Social and Governance reporting obligations

a. Corporate Sustainability Reporting Directive (CSRD) is effective from the 2024 fiscal year for largest listed companies
b. Scope extended to smaller listed entities and large companies thereafter.
c. Tax governance reporting may be a crucial part of ESG-reporting

Fit for 55

a. Reform of EU Emissions Trading System
b. Carbon Border Adjustment Mechanism
c. EU Energy Tax Directive

EU developments

Public country by country reporting

a. MNEs that are active in the EU with consolidated annual revenues exceeding EUR 750 million will have to publish the amount of tax they pay in each individual EU Member State and, on aggregate, outside the EU (‘Public CbC Report’)
b. The data provided by companies needs to be broken down into specific items, which include
    i. the nature of the company’s activities,
    ii. the number of full-time employees,
    iii. the amount of profit or loss before income tax,
    iv. the amount of accumulated and paid income tax and accumulated earnings.

c. The Public CbC Report must be published on the internet, using a common template.

EU developments

PCBCR applies to (i) EU headquartered MNEs and (ii) non-EU headquartered MNEs that have medium- or large sized subsidiaries or branches in the EU.

To qualify as a medium- or large sized subsidiary or branch, two of the following three (accounting) criteria must be met:

i. a balance sheet exceeding **EUR 5 million**;
ii. a net turnover exceeding **EUR 10 million**; and
iii. an average number of employees exceeding **50**

PCBCR is generally implemented in way that first reporting years starts on or after 22 June 2024.

EU developments

Framework on cross-border teleworking

a) As of 1 July 2023, new rules apply to employees teleworking from home in cross-border situations within certain European countries (‘cross-border teleworking’). If employees telework less than 50% of their agreed-upon working time in their state of residence, the social security legislation of the state in which the employer has its place of business or registered office may remain applicable.

b) The new rules are laid down in a Framework Agreement, which applies to the EU Member States that have signed the Framework Agreement, as well as to Liechtenstein, Norway and Switzerland.

Directive on Administrative Cooperation

DAC 6

Spontaneous filing of *potential aggressive tax arrangements*… → within 30 days!!!

Hallmarks to be checked on “cross border” transactions;

Filing under DAC6 doesn’t mean a transaction is considered as *abusive*!!!

DAC 7

Digital platforms (not for own goods!!!) → filing over 2023 before the end of January 2024!!!

High fines for not being compliant…

Directive on Administrative Cooperation

DAC 8

Automatic exchange of information regarding *Crypto currency…* January, 1 2026.

OECD → Crypto-Asset Reporting Framework (CARF)

DAC 9 (?)

Exchange of information on shell companies → Unshell directive / ATAD 3 (see before).

Pillar 1

Profit Allocation and Nexus

- MNE’s with global turnover > 20 billion EUR **and** pre-tax profit > 10%;
- After implementation it will apply for > 10 billion EUR
- Digital Services Tax for “*marketing and distribution activities*” without ***real (acknowledged) fiscal presence;***
- The timing for the introduction of Pillar One is unknown and depends on its acceptance by a critical mass of jurisdictions.

Pillar 2

Global Minimum Taxation

- MNE’s which turnover exceed 750 million EUR;
- Minimum corporate income tax of 15% → *extra attention for low taxed countries!!!*
- GloBE income; ETR and Top-up Tax; IIR and UTPR;
- The European Union (EU) and a number of other jurisdictions intend to introduce Pillar Two from 2024, while other countries and territories have indicated they will introduce Pillar Two from 2025.
- A number of uncertainties remain, but Pillar Two is likely to be a **radical shift** in the tax landscape.

Pillar 2

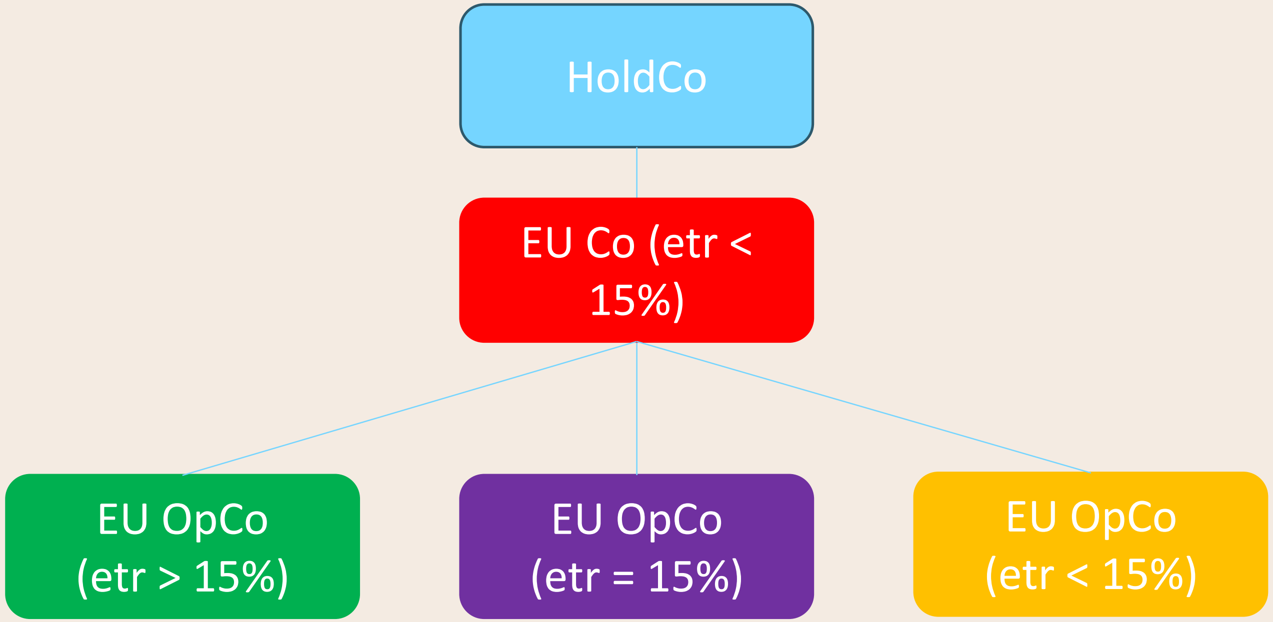
Global Minimum Taxation

- Global anti-Base Erosion (GloBE) – income;
- Effective Tax Rate (ETR);
- Income Inclusion Rule (IIR) → top up tax with the Ultimate Parent Entity;
- Undertaxed Payment Rule (UTPR) → denies deductions / extra taxation at the level of subsidiaries (in stead of the Ultimate Parent Entity);
- Domestic Minimum Tax (DMT).

- Excluded Entities are Governmental Entities, International Organisations, Non-profit Organisations, and Pension Funds as well as any Investment Fund or Real Estate Investment Vehicle that is the ultimate parent entity of a multinational Group.

Pillar 2

Global Minimum Taxation



→ In case EU OpCo ETR < 15% there will be additional taxation at either HoldCo and / or EU Co to reach the 15% ETR for the group!!!

Conclusions

- ***Despite most of the new EU proposal <u>look (at first glance)</u> to (only) affect the bigger Multi National Enterprises it will also impact Small and Midsized Entities…***

- ***More than we think SME are part of such a bigger MNE Group, which means they will have to comply as well…***

- ***In general it is expected after implementation the critical amounts will decrease, so more entities will be hit directly…***

- ***Therefore it is (more and more) important to follow up on the EU proposals…***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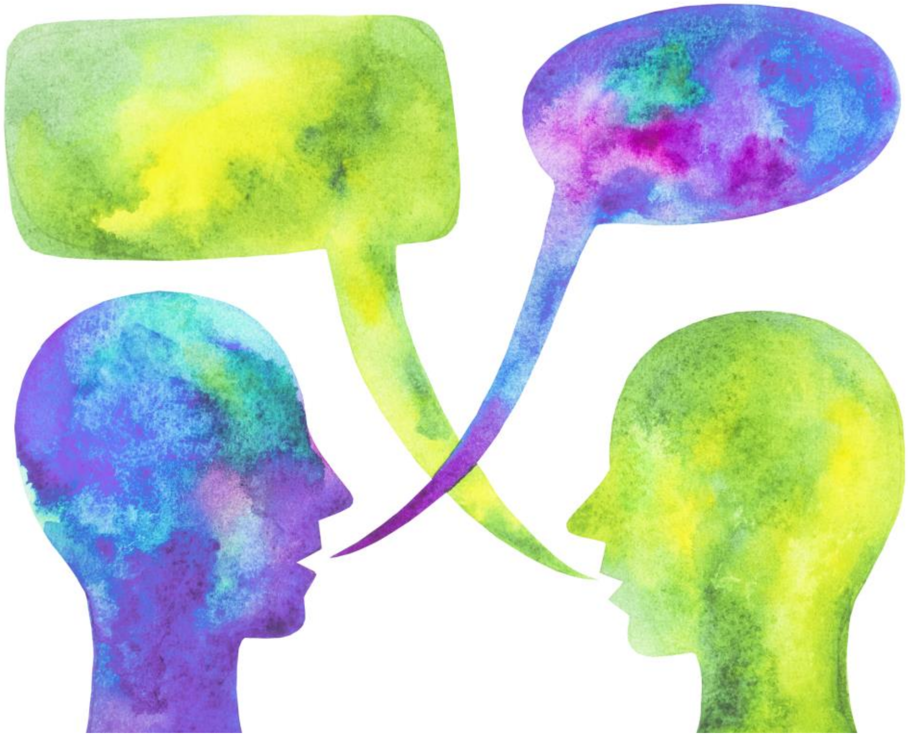

Panel Discussion