EU Gateway Publication

Year-end transfer pricing adjustments and indirect taxes

May 2025

In this EU Gateway publication, we present the broader tax and commercial implications of making end of year transfer pricing adjustments for multinational groups operating in the EU. This article is the first in a series of planned articles which outline the interaction between transfer pricing and indirect taxes.

1. Year-end transfer pricing adjustments, VAT and Customs in a nutshell

Transfer pricing adjustments which are processed within a taxpayer's statutory accounts before they are closed have more than just direct tax implications for multinational groups operating in the EU. This article highlights the importance of aligning transfer pricing outcomes with the arm's length principle and addresses the potential VAT and customs implications of such adjustments. Furthermore, this article emphasizes the need for correct and timely adjustments to ensure tax compliance and to reduce administrative burden.

EU Gateway

EU Gateway – an initiative of PwC Netherlands – is dedicated to provide coordinated support for clients to navigate through the complex EU tax and legal landscape. Through our extensive network of tax and legal specialists we offer coordinated assistance, helping clients understand and comply with the complex tax and legal regulations in the EU.

For comments or questions regarding this EU Gateway publication, please contact:

Dr. Vassilis Dafnomilis
Senior Manager Tax
(Tax Knowledge Centre/
EU Gateway)
vassilis.dafnomilis@pwc.com
PwC Netherlands

Niek van der Put
Director Tax
(Transfer Pricing)
niek.van.der.put@pwc.com
PwC Netherlands

Bart van Osch
Director Tax (VAT)
bart.van.osch@pwc.com
PwC Netherlands

Andre Stoop
Director Tax (Customs)
andre.stoop@pwc.com
PwC Netherlands

For market related questions please contact:

Jeroen Peters
Partner International
Tax Services
jeroen.h.peters@pwc.com
PwC Netherlands
(EMEA)

Chahid el Tarrahi
Partner International
Tax Services
chahid.el.tarrahi@pwc.com
PwC Netherlands
(Americas)

Pieter Janson
Partner International
Tax Services
pieter.janson@pwc.com
PwC Netherlands
(Asia)

Vincent Voogt
Partner International
Corporate Tax
vincent.v.voogt@pwc.com
PwC Netherlands
(USA)

Mohammed Allaoui
Partner International
Corporate Tax
mohammed.allaoui@pwc.com
PwC Netherlands
(USA)

2. The arm's length principle for transfer pricing purposes

The arm's length principle prescribes that the terms and conditions (including pricing) of transactions entered into between associate entities of a multinational group should align with those entered into between independent parties in comparable circumstances.

Where profit outcomes are inconsistent with the arm's length principle, transfer pricing adjustments may be required to align the outcomes with the arm's length principle.

Transfer pricing adjustments

To achieve consistency with the arm's length principle, taxpayers and/or revenue authorities may resort to making transfer pricing adjustments. Transfer pricing adjustments may be made in-period as a corrective measure, or after closing the relevant period as a year-end adjustment. Transfer pricing adjustments always need to be documented and understanding jurisdictional differences is critical. In some jurisdictions historically, transfer pricing adjustments have been processed only by adjusting a taxpayer's taxable base to achieve consistency with the profits which would have accrued at the taxpayer, had arm's length conditions been applied. In other jurisdictions, particularly in an EU context, accurate delineation of the non-arm's length transactions and understanding of the consequential impacts is critical, for the reasons outlined below.

For the purposes of this article, we have considered only transfer pricing adjustments which are factored into a taxpayer's books at or before closure of a relevant period.

With an increase in the use of taxpayer data by revenue authorities, higher levels of tax transparency, changes to the global regulatory landscape and taxpayer ERP/IT systems, correct and timely transfer pricing adjustments (in period) are now critical for the acceptability of the adjustments by tax authorities in jurisdictions on both sides of the transaction.

3. Relevance for Pillar I (Amount B), Pillar II and Country-by-Country Reporting

In anticipation of Pillar I (Amount B) and Pillar II initiatives further progressing, year-end transfer pricing adjustments should also be considered in this context.

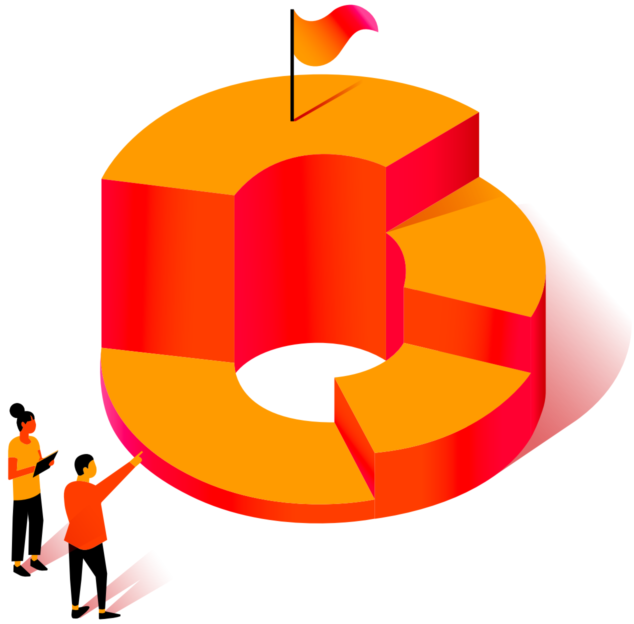
Pillar I Amount B is intended to simplify transfer pricing by proposing a fixed return for certain baseline marketing and distribution activities, dependent on industry profile and asset intensity – for certain qualifying entities falling within scope of Pillar I. **In-period transfer pricing adjustments (and Pillar I/II calculations) will be critical to ensure alignment with Pillar I Amount B outcomes.**

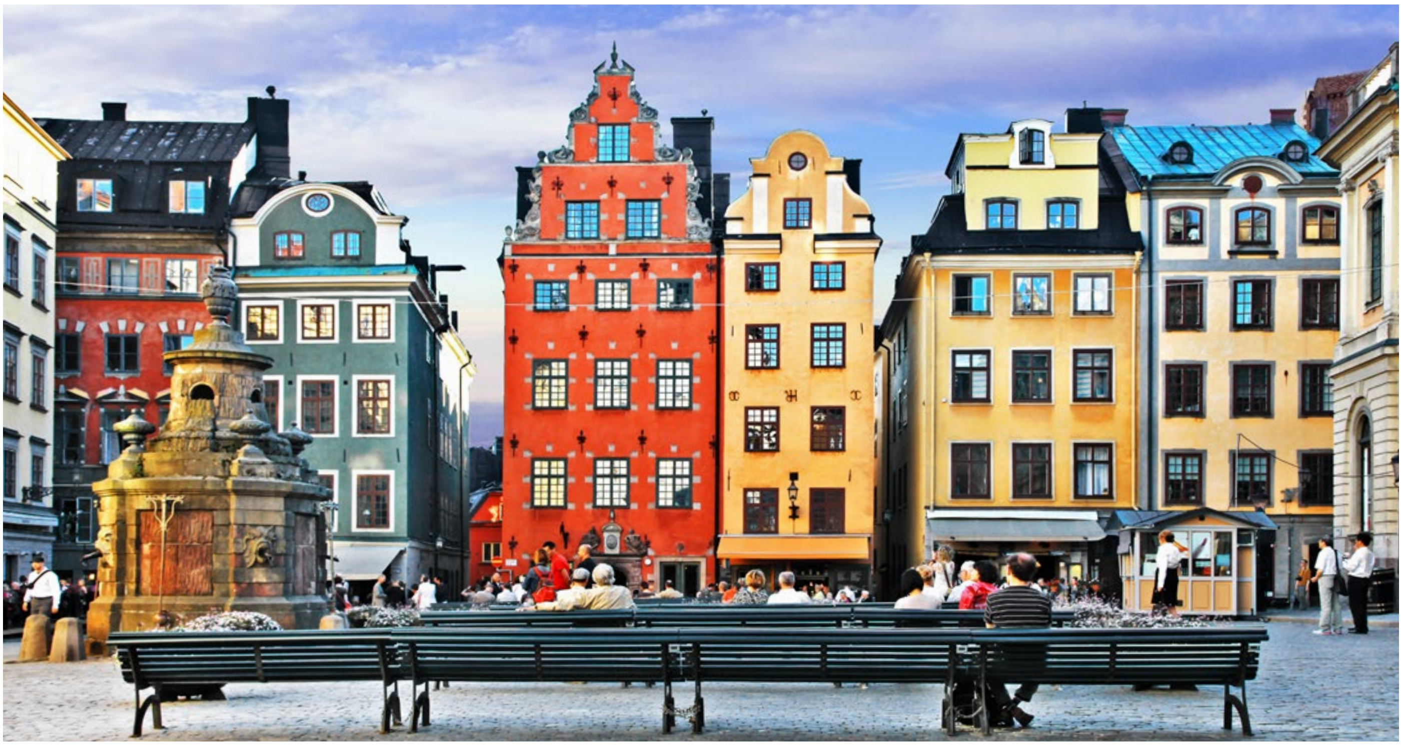
Pillar II is intended to ensure MNEs pay a minimum level of tax on profits, with a minimum effective rate of 15% at the jurisdictional level, if falling within scope of Pillar II. Pillar II calculations are to be performed based on accounts relied upon for the preparation of consolidated group accounts. For MNE groups which perform transfer pricing adjustments after period close – but factor these year-end adjustments into their local accounts/tax returns - this presents a potential discrepancy with consolidation data relied upon for Pillar II calculation purposes.

In the absence of guidance which outlines the preferred approach for dealing with transfer pricing adjustments post-year end, such adjustments may give rise to an increase in tax and/or administrative burden - double taxation, a requirement to adjust historical Pillar II calculations, and incorrect CbCR or Pillar II safe harbour calculations.

4. VAT considerations

From an EU VAT perspective, as a starting point the taxable amount is based on the subjective value of the consideration. In other words, it is the value which is actually received for a specific supply of goods or services, rather than a value based on objective criteria. As long as a value is not symbolic, it is considered the applicable transactional value for VAT purposes.





However, if a MNE operating in the EU carries out an (end of year) transfer pricing adjustments, this may also result in an adjustment for VAT purposes. More specifically, the taxable amount for a prior transaction might have to be adjusted down- or upward. Whether such an adjustment should be made, depends on a number of factors.

Most importantly, one should be able to establish a direct link between the (year-end) adjustment and a specific (group of) transaction(s) (i.e. a supply of goods or services). This is generally the case if a reciprocal legal relationship can be established between a supplier and a recipient of that transaction, based on which a remuneration is received from the recipient in return for a supply of goods or services from the supplier and for which an invoice is issued. **Further, an identifiable benefit to an identifiable recipient should be present.** Such a direct link should in principle stem from the contractual agreements, but it is not limited to what is stipulated in the contract. Transfer pricing documentation, as well as transactional documentation (e.g. invoices, credit notes, purchase and sales orders or even correspondence) may be considered relevant as well.

If no direct link between a (year-end) adjustment and a specific transaction can be identified, it should be analyzed whether the adjustment should be considered the remuneration for a new supply of a service, which may also result in VAT implications for both the supplier and recipient, or as a transaction outside the scope of EU VAT. The latter situation in principle only occurs when adjustments take place in the capital sphere, when it concerns a mere profit adjustment or where adjustments are forced by tax authorities through an adjustment of the Corporate Income Tax return filed priorly.

Assuming a direct link between a specific (previous) transaction or a new service is established, this likely requires the MNE to correct their (previously filed) VAT returns to remain compliant. Complex issues may arise with respect to the timing of these adjustments and – from the recipient's point of view – the right to recover input VAT, particularly in case of a limited VAT recovery right which is common for companies with, for example, financing or holding activities. Significant administrative and/or system (e.g. ERP) burdens may also arise and should therefore be addressed, e.g. by assigning appropriate tax coding to enable correct processing of the adjustments.

Separately, the EU VAT Directive allows Member States to use the 'open market value' for transactions to prevent tax evasion or distortion of competition. The conditions and valuation methods when determining the open market value for VAT purposes differ compared to the assessment of an arm's length price for direct taxation purposes and should thus be considered carefully, if applicable. In this respect, a number of EU Member States have opted to adopt this provision into their national legislation.

EU VAT case law is also continuously evolving in relation to the matter of TP adjustments and their relevance for VAT (e.g. current three pending ECJ cases (C-808/23, C-726/23 and C-603/24), specifically on this topic).

In conclusion, year-end transfer pricing adjustments do not necessarily lead to VAT implications, but where they are an adjustment of prior transactions, it should be analyzed for any such potential effects and it is important to get the issuance of any documentation (e.g. credit notes or invoices) first time right. If VAT effects are present, they can lead to significant administrative burdens and potential risks of VAT assessments, fines, and late payment interest liabilities if not dealt with properly.

5. Customs implications

Transfer pricing adjustments that relate to the sales/purchases of products may be relevant for customs purposes. Note that customs valuation relates to the importation of goods, so services are mostly not relevant from a customs valuation perspective. An exception applies to payments for certain services that are related to the imported goods, such as transportation and insurance, design and development, trademarks, royalty (IP). This will be the case when these transfer prices to be adjusted are used for determining the customs value of products imported into the EU under the transaction value method. This transaction value method is the most applied method for determining the customs value of products imported into the EU.

The transaction value is the price paid or payable for the imported products and transfer prices between related companies can be used for the transaction value method, provided that the relation between the entities did not influence the prices. In other words, the prices must be at arm's length. **Although the objectives of customs valuation and transfer pricing principles are different, in that the customs valuation basically looks at the individual transactions whereas transfer pricing is considering the overall result of transactions in a certain period (e.g. a year), transfer prices that are at arm's length may be acceptable as the basis for the transaction value from a customs perspective.** When transfer prices are used as the basis for the transaction value, it may be necessary to add certain cost elements for calculating the customs value, when these cost elements (e.g. costs of design and development or freight and insurance) are not covered by/included in the transfer prices.

Since the transaction value is the price paid or payable for the imported products, the year-end transfer pricing adjustments do in fact change the prices paid for the imported products and thus also the basis for the customs value reported upon importation. As explained the customs value is transactional based and therefore the year-end transfer pricing adjustments must be allocated to the individual import entries for correcting the customs value reported in these import entries. This allocation must be made to the satisfaction of the customs authorities.

Following the decision of the European Court of Justice in the Hamamatsu-case (C-529/16), there has been some debate in the EU on whether transfer prices that are adjusted at year-end can be accepted as a basis for the customs value. Although there is no definitive outcome on this, in practice many EU customs authorities do still accept transfer prices as a basis for the customs value, provided that year-end transfer pricing adjustments are reported, and additional customs duties are paid for upward transfer pricing adjustments. Obtaining a refund for downward adjustments may be more challenging and will typically depend on upfront agreements with the customs authorities on the method for determining the customs value.

Summarizing, when year-end transfer pricing adjustments relate to transfer prices that are used as the basis for the customs value of imported products, they will be relevant for customs purposes and upward adjustments will lead to additional customs duties being charged.

6. Other

The formalities of processing a transfer pricing adjustment should also be considered. For example and in addition to commercial/accounting requirements, conformity with local transfer pricing documentation requirements which may require demonstration that tested party financial data used in applying the selected transfer pricing method ties to the financial statements, and a description for concluding that the relevant transactions were priced (post-adjustment) on an arm's length basis.

This publication was created by PricewaterhouseCoopers Belastingadviseurs N.V. and concluded on 10 January 2024. Subsequent developments have not been taken into account unless otherwise stated. This publication does not serve as the official input from PwC on the consultation of the European Commission on the TP Directive.