How do you drive transfer pricing certainty in uncertain times? (PART 1)

ISAAC SARPONG: Isaac is the Partner in charge of Tax Services. He has over 26 years' experience in the provision of multi-faceted advice to both local and international clients in taxation, accountancy, audit & assurance, and corporate law, among others. Isaac is a Chartered Accountant, a Chartered Tax Practitioner and a Lawyer.

The 2024 EY International Tax and Transfer Pricing Survey finds businesses need a robust transfer pricing policy to manage new risks.

In brief

- Respondents are worried about effective tax rate instability as Pillar Two global minimum taxes take effect. Inflation and ESG are added pressures.
- Tax departments should focus on driving transfer pricing certainty through standard data and changing processes to facilitate dispute resolution.
- Tax and TP professionals should partner with the C-suite on business decisions to increase certainty from the onset of business change.

Concerns about double taxation resulting from global tax reform are fundamentally transforming the way businesses think about transfer pricing (TP) certainty and their operational TP needs, the 2024 EY International Tax and Transfer Pricing Survey of 1,000 TP professionals shows.

An overwhelming majority of respondents say they face a moderate or significant risk of double taxation related to the Organisation for Economic Co-operation and Development (OECD) Inclusive Framework on Base Erosion and Profit Shifting (BEPS) project, which introduces various new tax regimes under Pillar Two, including a new global minimum tax of at least 15% for multinational enterprises. More than 50 jurisdictions worldwide are in various states of implementing those rules, some as early as this year.

The survey shows that the concern about double taxation, broader tax and legislative change and business volatility are driving TP change within organizations in many important ways.

Fearing double taxation

84%

of survey respondents say they face a moderate or significant risk of double taxation due to global tax reforms

First, businesses are increasingly seeking certainty on their TP positions to facilitate more predictability in new calculations required to comply with the Pillar Two rules. This is evidenced by a surge in levels of interest in advance pricing agreements (APAs) and dispute resolution programs offered by tax administrations. This proactive approach allows for more certainty in both TP disputes and Pillar Two implementation.

Second, both executives and TP professionals realize that data, in particular standard transfer pricing data, underpins certainty in controversy and predictability of Pillar Two calculations. The transition into both a tax environment in which the minimum taxes described in Pillar Two, as well as a more transparent world related to public disclosures of the Country-by-Country Reports, are compelling corporations to attempt to standardize their internal data to manage the groundswell of tax authority controversy-related requests and Pillar Two calculations. Specifically, standardized data will help businesses address workload demands and effectively manage current and anticipated tax controversy. More control over their data will also help businesses manage increasing demands for public transparency about their tax payments globally.

Finally, TP executives are recognizing that they perform a very strategic role in their organizations. In this new world, where double taxation risks have increased rapidly, TP executives need to be more connected with the rest of the business and rely on technology to perform more traditional operations and compliance functions. This is especially true given the pressures of other externalities, including inflation, rapid changes in supply chains, and initiatives related to their organization's environmental, societal and governance (ESG) objectives.

"There's a premium on transfer pricing certainty that never existed before," says Tracee Fultz, EY Global Transfer Pricing Leader. "Transfer pricing uncertainty has too many downstream impacts on significant business decisions, including capital outlays and the potential for double taxation."

Respondents report the impact of the BEPS project is unmistakable:

84% say they face a moderate or significant risk of double taxation due to BEPS Pillar One and Pillar Two initiatives.

82% say tax rate stability will have a moderate or significant impact on their global TP policy over the next three years.

71% say global minimum taxes will have a moderate or significant impact on their TP policy.

> "There's a premium on transfer pricing certainty that never existed before."
>
> **Tracee J Fultz**
> EY Global Transfer Pricing Leader

As a result, respondents expressed more interest in APAs and similar programs than at any other time in the 30-year history of the survey:

61% of bilateral APAs and **59%** of multilateral APAs will be "very useful," up from 34% and 30%, respectively, in 2021.

59% say unilateral advance pricing agreements will be "very useful" in managing transfer pricing-related controversy over the next three years, more than double the 2021 proportion of 29%.

46% say mutual agreement procedures (MAP) will be "very useful," up from 33%.

41% say the International Compliance Assurance Program (ICAP) will be "very useful," up from 27%.

The combined survey results point to a groundswell of businesses that are now looking for some type of cooperative forum to settle their transfer pricing disputes. This is a significant change from prior surveys when most companies preferred to deal with the outcomes of audits by tax authorities and signals a general need to take a more proactive approach to their transfer pricing rather that a reactive one.■

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How do you drive transfer pricing certainty in uncertain times? (PART 2)

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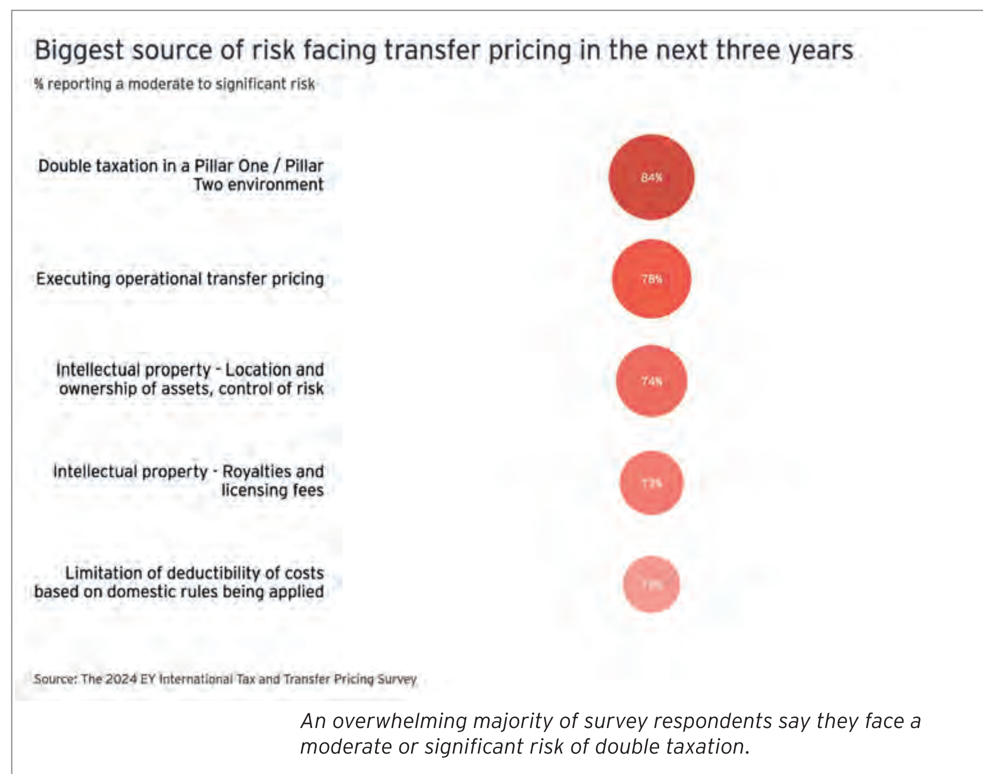

An overwhelming majority of survey respondents say they face a moderate or significant risk of double taxation.

It is also clear that to achieve the certainty they seek with multiple tax authorities, standardizing data and overcoming challenges with transfer pricing operations and execution has become critical. But overwhelming proportions of respondents say they struggle in these key areas:

75% say ineffective use of technology was their first or second biggest challenge.

67% rank "poor data quality" as their first or second biggest challenge.

73% say investing in advanced operational transfer pricing technology would result in moderate or significant improvement in risk management.

Survey methodology

The 2024 EY International Tax and Transfer Pricing Survey was conducted by an external independent vendor from September to October 2023. The double-blind study queried 1,000 executives at large companies in 47 jurisdictions and across 19 industries about a variety of international tax and TP issues. The EY organization was not identified as the sponsor of the survey.

CHAPTER 1

How more controversy accelerates the case for a new TP certainty lens

TP professionals are dealing with more transparency, shifting business priorities and the impact of issues like inflation.

Emerging technology, such as GenAI, and the massive amounts of data being produced daily will soon profoundly impact tax controversy. Respondents to the 2023 EY Tax Risk and Controversy Survey say they anticipate the number and intensity of audits to grow by 79% in the next two years compared with the previous two. TP was again identified as the top area for risk in that survey, as 53% of respondents say they expect tax authorities to focus more on cross-border tax issues in the coming years.

While TP has always been a flashpoint for tax controversy, the very nature of TP audits is changing. For one thing, authorities have more access to taxpayer information than ever. That data, combined with the power of GenAI and related technologies, will enable tax authorities conducting audits in the future to ask for more detailed information about positions taken today and to interrogate the data provided more effectively. That's why harnessing and standardizing data now is critical for businesses to respond effectively to these more intensive examinations.

"Audits conducted two or three years from now will likely be very different from the way they're administered now," says Joel Cooper, EY Global International Tax and Transaction Services (ITTS) Controversy Leader. "Therefore, you need to be thinking about your current actions in terms of these new ways in which they will be examined in the future."

To prepare for audits of the future, TP professionals need to think about two things: first, what does the world say about their business? And second, what does the company's data say about their business?

More transparency about TP

96%

of respondents say they face "some" or "substantial" additional work to prepare for public disclosure of Country-by-Country Reports

Assessing what the world says about the business involves understanding what is in the public domain and ensuring that TP policies and positions align with information available externally. Public regulatory filings, historical job advertisements, social media profiles, news articles and intellectual property (IP) registrations are all information sources that tax authorities can and will be able to analyze collectively to evaluate risk and challenge positions.

"Audits conducted two or three years from now will likely be very different from the way they're administered now. "

Joel L Cooper
EY Global International Tax and Transaction Services Controversy Leader

Understanding the company's data means going beyond functional interviews and the other processes typically used during fact-finding for transfer pricing analyses. New sources of information that tax authorities routinely review include e-mail data, the calendars of key executives, the mobile devices and computers of company officials, HR profiles, job descriptions and reviews, social media postings, regulatory filings and financial data. ■

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How do you drive transfer pricing certainty in uncertain times? (PART 3)

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In both assessments, businesses should expect to soon use GenAI tools to take proactive initial steps to align their TP policies while identifying and addressing risks. This will help equip their people to build stronger repositories of supportive information and evidence to buttress their positions.

"Global tax reform, including new levels of transparency, has completely changed how TP departments prepare, analyze and present data," says Joe Lawson, EY Oceania Transfer Pricing Leader. "It's more important than ever to make sure positions are clear, defensible and easily understood."

Pre-filing agreements surge in popularity

Tax controversy is expensive and time-consuming for both businesses and tax administrators. In 2022 alone, respondents say they spent an average of US$56.3 million in tax costs over initial assessments in TP-related disputes. They also spent an average of US$24.7 million on penalties, interest and surcharges and US$21.3 million on legal fees, including litigation. While concerns about double taxation and the challenge of operationalizing TP functions topped the list of respondents' concerns, traditional sources of disputes during TP audits, such as IP, payments for contract manufacturing, limitations on some deductibility and a variety of cross-border transactions, were all rated as posing "moderate to significant risk" by at least half of respondents.

Amidst all these pressures – implementation of global minimum taxes, technology-empowered tax examinations, digitally generated automatic assessments, and traditional sources of disputes on audit – the new TP survey shows a surge in enthusiasm for various programs and tools governments offer to taxpayers who want to negotiate TP positions before filing tax returns. There is also growing interest in programs designed to make disputes less contentious when they arise.

Rising Reputational Risk

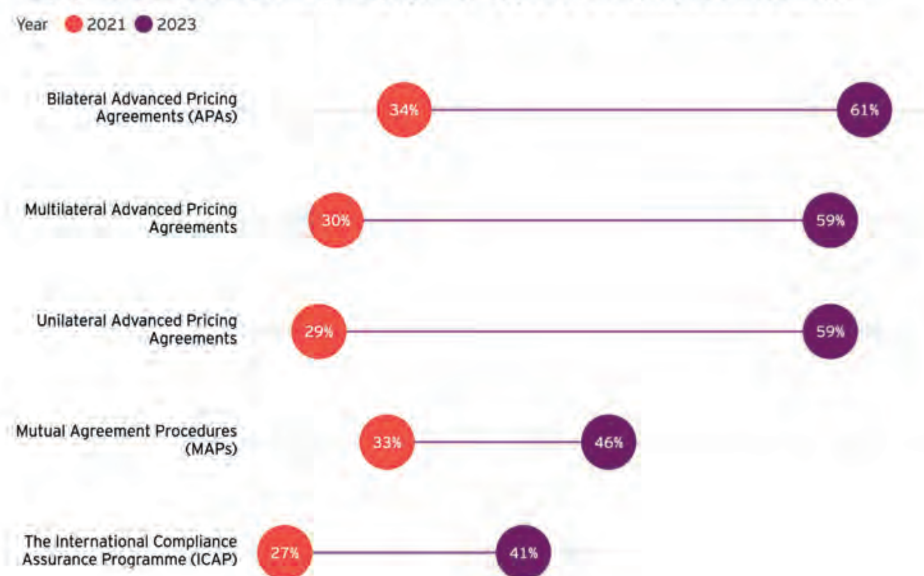
Tax and TP controversy has the potential to become even higher profile due to new transparency initiatives. Since 2018, the world's largest multinationals have been sharing country-by-country tax remittance details, much of it containing commercially sensitive information, with an increasing number of jurisdictions around the world. The reports aim to provide tax authorities with more details about taxpayers' global operations, including how tax obligations and business activities align in specific jurisdictions.

Some jurisdictions, including Australia and the EU, have signaled their intention to make businesses publish data from those reports, increasing reputational risks if stakeholders misinterpret the disclosures.

This poses a major challenge for TP professionals. Ninety-six percent of respondents say it will take "some" or "substantial" additional work to prepare for these new public disclosure requirements. Most of that work will be spent on a combination of performing new data analysis and developing a narrative explanation to put the disclosure in proper context, respondents say. Indeed, 86% of respondents say reputation risk management is "somewhat" or "very" important in driving their TP policy.

A post-Pillar Two world with more information than ever available about multinational enterprises will require managing internal and external forces. Establishing guiding principles is critical. Following them is essential.

One of the survey's most notable, yet unsurprising findings is the dramatic increase in interest in advance pricing programs. In the past, survey respondents have expressed some hesitation about participating in such programs, citing the time involved in setting them up, among other things. Now, however, the proportion saying these programs will be "very useful" to them in the future has more than doubled.



Interest in APAs and similar programs surges more than any other time in the 30-year history of the survey.

"APAs provide an element of certainty that has more value in a Pillar Two world," Fultz says. "There is now far more downside risk to having a position challenged than there's been in the past."

CHAPTER 2

How broader pressures on the business are affecting TP

Inflation, supply chain changes and ESG are all acute business pressures.

Beyond Pillar Two-related concerns about double taxation and the increased risk of controversy, TP professionals have had to help manage the impacts of broader business decisions. Some of these in recent years have included responses to inflation, changes in supply chains and commitments to ESG objectives. The cascade of externalities complicating their roles has only grown since the pandemic. All of these have significant business impacts for cash flow, earnings per share and brand perception. ■

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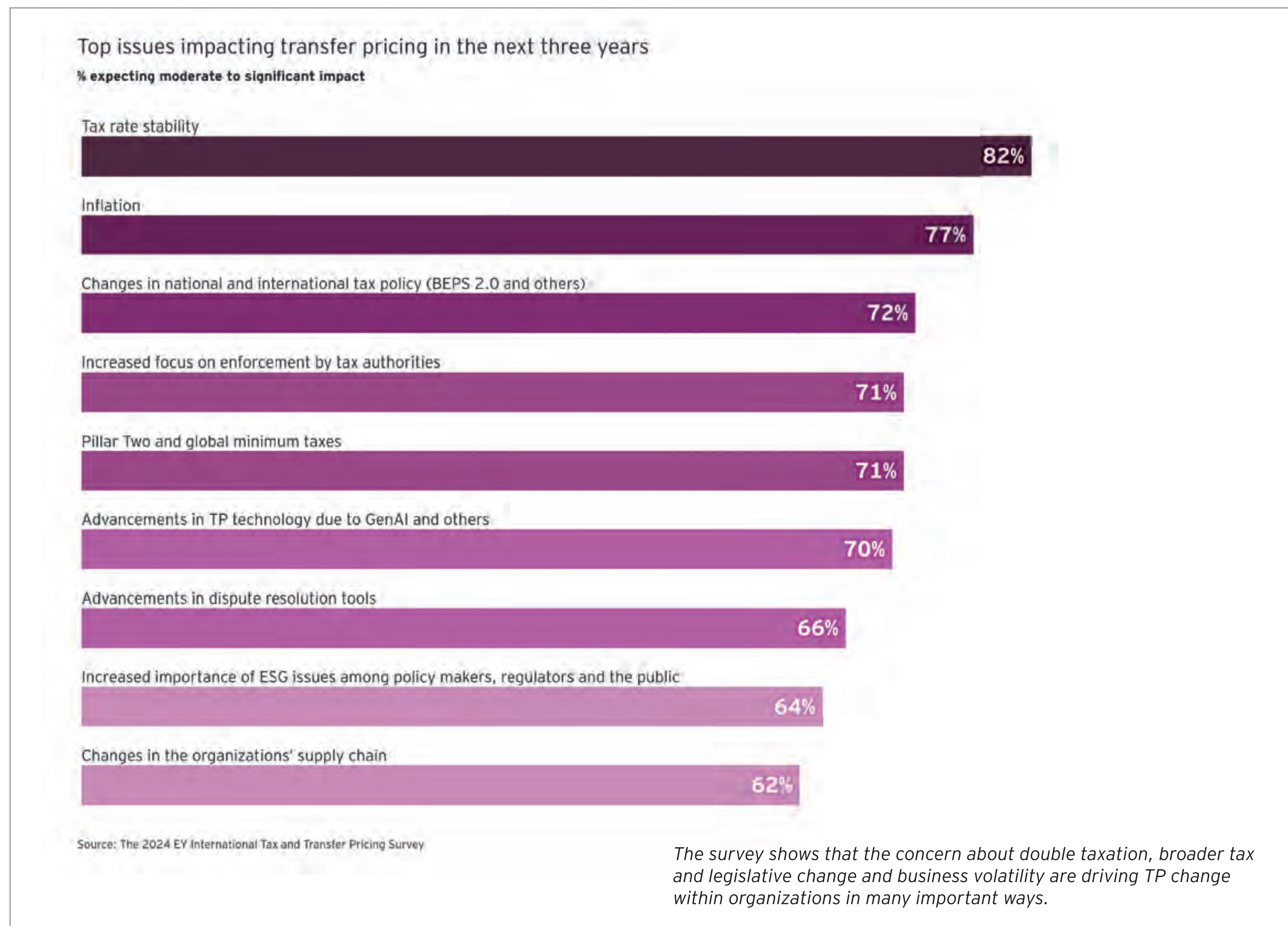

The survey shows that the concern about double taxation, broader tax and legislative change and business volatility are driving TP change within organizations in many important ways.

Inflation, for example, wasn't even asked about in the previous 2021 survey; this year, 77% of respondents say inflation will have a moderate or significant impact on their transfer pricing policy over the next three years, second only to the importance of tax rate stability. Fifty-one percent of respondents say higher interest rates because of inflation have most impacted their medium and long-term intercompany debt pricing. In contrast, 27% say interest rates have had the biggest impact on factoring arrangement pricing. Twenty-one percent cite cash pool pricing as being most impacted by higher rates.

Inflation takes a toll

77%

of respondents say inflation will have a moderate or significant impact on their TP policy over the next three years

Higher interest rates have also affected broader business decisions, many of which have implications for transfer pricing – 41% of respondents say their organizations have either increased or significantly increased their use of re-shoring or near-shoring strategies. In comparison, 54% say their organizations have significantly decreased expansion into new markets. Fifty-five percent of respondents say they are decreasing their expansion into new markets due to higher interest rates, while 61% say they are increasing the use of re-shoring or near-shoring.

"Inflation and the higher interest rates to combat it will continue to have an effect on transfer pricing for years," says Jay Camillo, EY Global Operating Model Effectiveness Leader. "To the extent it contributes to a trend of more bloc trading and less reliance on extended and linear supply chains, it will keep TP professionals busy dealing with the new value and supply chains that will be created as a result." These are significant capital decisions that amplify the strategic value that transfer pricing professionals are providing.

"Inflation and the higher interest rates to combat it will continue to have an effect on transfer pricing for years."

Jay Camillo
EY Global Operating Model Effectiveness Leader

Supply chains and ESG

Supply chains have also changed radically since the pandemic. Forty-two percent of respondents say their organizations have relocated production from one jurisdiction to another in the last three years because of geopolitical issues, the number one reason cited; thirty-nine percent of respondents say they've made changes linked to changing tax policies. Nearly a third (32%) cited disruptions related to the COVID-19 pandemic. Respondents also say supply chains will continue to be a factor, with 62% saying they anticipate changes to supply chains having a moderate or significant impact on their TP policy in the coming three years.

Supply chains

62%

of respondents say changing supply chains will have a moderate or significant impact on their TP policy in the coming three years

ESG continues to be a major focus of C-suites, with initiatives affecting TP. Just 28% of respondents report already having changed their TP policy to account for their ESG policy, consistent with the 28% reporting their organizations are at an advanced stage of their ESG journey. With more than 70% of respondents still in the process of assessing supply chain changes to meet ESG goals, ESG will continue to represent a major workstream for TP professionals in the coming years.■

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Are unrealised foreign exchange gains taxable under the tax laws of Ghana?

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The question of whether unrealised foreign exchange gains arising from financial instruments are taxable under Ghana's tax laws has engendered debate among consultants, practitioners, officers of the Ghana Revenue Authority (GRA), and the general public for some time now. This has become topical following the promulgation of the Income Tax (Amendment) Act, 2023, Act 1094.

In the Income Tax Act, 2015, Act 896 (as amended) (the ''ITA''), the Parliament of Ghana defines key concepts including 'financial instrument', when financial cost is incurred, and when financial gain is derived.[1] A realised foreign exchange gain occurs when, among others, a financial instrument is sold or disposed of, resulting in a profit. The gain is considered ''realised'' because it has been converted into cash or an equivalent asset. On the other hand, an unrealised foreign exchange gain occurs when, among others, there is an increase in the value of a financial instrument that has not yet been sold or disposed of. It represents a paper profit because it has not yet been officially realised as cash or its equivalent.[2] Unrealised foreign exchange gains fluctuate in value based on market conditions.

To better illustrate when an unrealised foreign exchange gain occurs, let us consider the case of an interest rate swap. In simple terms, a swap is a derivative instrument in which two parties agree to exchange cashflows or assets based on predetermined terms. Swaps are primarily used to hedge risks and involve underlying assets such as interest rates, currencies, etc.

For example, at the start of a swap agreement, Party X agrees to pay a fixed interest rate of 35% annually to Party Y, while Party Y agrees to pay a variable interest rate tied to a benchmark rate such as the Bank of Ghana Monetary Policy Rate (MPR) (say, at an initial benchmark rate of 30%). If the benchmark rate drops to 27% after a period of time, Party Y, which pays the variable rate, will benefit from the lower interest rate environment due to the decline in the interest it will be paying to Party X.

This situation creates an unrealised gain for Party Y. The gain is unrealised because the swap agreement is in force, and Party Y has not yet exited the swap or realised the gain through termination or settlement of the contract.

This article focuses on the potential lacuna concerning the taxation of unrealised foreign exchange gains for taxpayers.

Key Tax Provisions with respect to Foreign Exchange Gains under the ITA

The question of whether an unrealised foreign exchange gain is taxable depends on whether it meets the relevant provisions provided under the ITA. Before I proceed to discuss the taxability or otherwise of an unrealised foreign exchange gain, it is crucial to point out that Section 25 of the ITA, which talks about foreign currency and financial instruments, does not stand alone. The section starts with the wording *''this section applies where under the rules in Division II or IV of Part II...''*.

Part II of the ITA presents what constitutes income of a person and what should be deductible for tax purposes. Division II focuses on ''Assessable Income'' while Division IV touches on ''Deductions''. The combined effect of Sections 5(2)(a)(iii) and 6(2)(a)(ii) of the ITA (both of which fall under Division II, as indicated above) is that a taxpayer who has not made a gain from the realisation of a capital or investment asset cannot be said to have earned income from business or investment. Section 38 of the ITA further lists circumstances that result in the realisation of a capital asset.

I refer to the case of **Kassar v. Comptroller of Customs and Excise [1963] 1 GLR 109-122** which discusses the appropriate canon of interpretation expresio unius est exclusio alterius. This principle means that the express mention of one implies the intended exclusion of another in a pair or group not so mentioned. Section 25 of Act 1094 provides in unambiguous terms that unrealised foreign exchange losses are to be disallowed as deductions for the purposes of determining the assessable income of a taxpayer.[3] The question that lingers on in the minds of tax consultants is why the same unambiguous language was not used in the case of unrealised gains?

Now, let us turn to some of the reasonings advanced by proponents who argue for the inclusion of unrealised gains as part of the assessable income of a taxpayer.

Firstly, it is argued that a close reading of section 5(2)(a)(vii) of the ITA seems to suggest that an amount derived by a taxpayer that would have otherwise been included in calculating investment income of that taxpayer is classified as business income.

However, it is worth noting that section 5(2)(a)(vii) should be read in the context of section 6(2)(a)(ii). A strict interpretation of this latter section implies that the income from investment referred to therein does not cover ''unrealised'' matters within the context of realising an investment asset.

In the case of **Perseus Mining (GH) Ltd v. The Commissioner-General, Suit No. H1/137/2022 (Unreported)**, the Court of Appeal at pp 27 stated that *''... forward sales contract price, therefore, is the price of selling gold by using forward sales contracts which is a derivative financial instrument recognized and accepted under S. 131(1)(a)(ii) of the Income Tax Act, 2015 (Act 896) ...''*

The Court of Appeal further stated that *''... On the other hand, if at the time of delivery the spot price has shot up, the difference is treated as profit for purposes of tax assessment. In other words, the profit is added to his business income and assessed to be taxed.''*

From the foregoing, it appears that the decision of the Court of Appeal, although limited to whether or not a loss from a derivative instrument is deductible from business income, casts doubts on the position that gains from a derivative, unless realised, may not be deemed taxable.

Recommendation

It is my opinion that, to the extent that Parliament of Ghana in its wisdom stated clearly and in unambiguous terms that unrealised foreign exchange losses are not tax deductible, similar amendments ought to be passed for unrealised foreign exchange gains. This is important because:

1. It has the potential to cause revenue loss for the government - especially, where taxpayers consider this as non-taxable income amid the uncertainty surrounding it.
2. It will relieve taxpayers of the burden of paying interest years later where the revenue authority (and the courts) hold that the gains were taxable after all. ■

The views reflected in this article are the views of the author and do not necessarily reflect the views of the global EY organization or its member firms.

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[1] Section 131(3)(a) of the ITA provides that "... a person derives a financial gain when the person derives interest from a financial instrument."

[2] Section 38(1)(a) of the ITA provides that "... a person who owns an asset realises the asset if that person parts with the ownership of that asset, including when that asset is sold, exchanged, transferred, distributed, redeemed, destroyed, lost, expired or surrendered."

[3] Section 25(6) of the ITA provides that "an unrealised foreign exchange loss shall not be allowed as a deduction."