The price is right? The role of transfer pricing across supply chains of multinational companies

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Global trade has long thrived on the integration of supply chains, but rising protectionist policies–most notably in the United States–are disrupting this landscape, creating uncertainty for businesses and supply chains.

Traditionally, tax considerations have followed business decisions: multinational companies determine where and how to operate based on strategic and commercial factors, while tax teams refine structures for optimization. However, as the world's largest economy imposes tariffs on its trading partners, transfer pricing is becoming more important in commercial decision-making. While not the primary driver of decision-making, it is increasingly shaping corporate strategies amid geopolitical shifts.

Key takeaways for multinationals

1. **Evaluate risk** : Businesses should assess their risk tolerance and identify their preferred path forward during this period of uncertainty. This includes determining whether smaller, short-term adjustments or more significant, long-term structural changes best align with their strategy. Leveraging data-driven decision-making and modeling can help guide this process. A key consideration will be to determine which entity is responsible for the cost of tariffs.
2. **Short-term adjustments** : Multinational companies should conduct a new transfer pricing study to assess whether adjustments to their intercompany pricing strategy are available (e.g., in response to changes within their business or industry, changes in terms and conditions of intra-group legal agreements, entering Advance Pricing Arrangements (APAs)).
3. **Long-term restructuring** : Organizations may explore opportunities to restructure their corporate operations framework, potentially considering relocating manufacturing or business units and even reviewing and potentially re-allocating functions and risks more generally. Additionally, supply chain functions, the terms and conditions of intercompany agreements, and organizational risk allocations should be reassessed to better allocate risk within a multinational corporate structure.

Background

Multinational companies take part in complex, global supply chains, and to the extent one entity in the group supplies goods, services, or intellectual property to another group entity, transfer pricing plays a key role in determining the price at which those transactions take place. Transfer pricing rules impact both income tax allocation and operational strategy, and governments scrutinize transfer pricing to prevent tax avoidance. This article explores how multinational companies can de-risk and diversify their intra-group supply chains amidst global economic uncertainty, and how transfer pricing influences these decisions.

How transfer pricing and tariffs intersect

Although transfer pricing and tariffs are distinct areas of law, they intersect. Transfer pricing can influence the cost base of a tariff, and tax authorities often collaborate with border agencies to ensure consistency in reported values. While transfer prices are not directly applied to tariff calculations, they can affect the tariff cost base. If adjusted by a tax authority, it may trigger a review by border agencies. Artificially lowering transfer prices to reduce tariffs will likely attract regulatory scrutiny and tax re-assessments from the outbound jurisdiction.

Uncertainty in the present

The uncertainty created by the current U.S. administration is likely to continue. Even if tariffs are withdrawn, they could resurface as a bargaining tool. Businesses must assess whether the risk lies in making large capital investments now (i.e., to move functions and risks) with the possibility that tariffs are lifted relatively quickly, or in making smaller adjustments now but causing delay in making more significant changes if tariffs remain for the long term. Businesses must evaluate their risk tolerance and strategy, using scenario modeling to assess potential approaches.

Making tough decisions in a volatile business environment

Given the fluid policy landscape, businesses should approach changes incrementally. A prudent approach would be to start with incremental adjustments, mitigating risk while conducting comprehensive studies and modeling exercises to evaluate the long-term feasibility of diversification and de-risking strategies. As new information emerges, these analyses should be continuously refined by incorporating additional parameters to support informed decision-making.

Practical advice

Services and intangibles are not (yet) subject to tariffs

Companies that operate exclusively in services and intangibles do not currently need to modify their intercompany transfer pricing arrangements in response to tariffs or retaliatory tariffs, which all apply to tangible goods. However, it is possible that this limitation to tangible goods may not continue to be the case as the situation develops.

Further, multinational businesses dealing in tangible goods often integrate services and intangibles within their global operations, making it difficult to "un-bundle" them as a practical matter. As supply chain adjustments are introduced, the management of these elements may also require reassessment.

Short-term strategies: Minimizing the tariff cost base

Businesses should explore opportunities to legally minimize the cost base on which tariffs are applied when goods cross the Canada-United States border.

If a transfer pricing study has not been conducted recently, or if there have been significant changes to the business or manufacturing efficiencies, a new study may be warranted. Companies might consider adjusting their pricing methodology within the scope permitted by the arm's-length standard, though this could increase the likelihood of an audit. The arm's length principle will need to be applied to the transaction in a business environment that imposes tariffs, and businesses must determine how to allocate that cost between the parties. Companies should review existing intercompany agreements and ascertain whether they need to be updated to allocate tariffs to certain parties and recalculate prices. All changes should be documented contemporaneously.

The Canada Revenue Agency (CRA) has not yet provided any guidance regarding who should bear the cost of tariffs from a transfer pricing perspective. During this time of uncertainty, Canadian entities in multinational companies transacting with affiliated U.S. entities should consider applying for a bilateral APA (BAPA), which would involve both the CRA and the Internal Revenue Service so that any price agreed upon between one taxpayer and its local tax authority is also acceptable by the other tax authority.

Before making large-scale structural changes, businesses should seek efficiencies within their existing supply chains. For example, reducing the number of times a product crosses the border, or separating raw materials from value-added services, and allowing raw materials to cross the border while services are provided post-entry.

Long-term considerations: De-risking beyond tariff uncertainty

Even if tariffs are lifted, businesses should continue evaluating supply chain diversification to mitigate future risks. For example, businesses might look to move manufacturing to the U.S. to serve their American customers, duplicate certain operations in other countries to avoid potential retaliatory tariffs, or even exit the U.S. entirely. This type of business restructuring can trigger tax audits in jurisdictions losing tax revenue as well as exit taxes.

The global trend toward protectionist policies suggests that tariff-related uncertainties may endure. The removal of one tariff threat does not preclude the imposition of new ones by the United States or other countries. Companies should evaluate structural changes that diversify their geographic footprint and consider adjustments to their transfer pricing frameworks to strategically allocate risk across their corporate structure.

Essentially, it puts a big premium on doing business with companies in countries that have trade agreements with Canada and that actually honour them.

This approach enables businesses to remain agile in the face of evolving trade policies while ensuring long-term resilience.

BLG can assist

We offer extensive expertise across all areas of Canadian tax, international tax, and transfer pricing complemented by deep experience in audit, litigation, and competent authority matters. Our team is well-equipped to support multinational companies navigating the complexities of a rapidly evolving global business environment. Contact us for help navigating your tax and transfer pricing needs.

By

Siwei Chen

Expertise

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