

22 December 2023

Transfer Pricing Directive

KEY MESSAGES



- 1** We support the Commission's objectives of increasing tax certainty and mitigating the risks of litigation and double taxation related to transfer pricing arrangements.
- 2** The proposed incorporation of the arm's length principle and key transfer pricing rules into the EU's legal framework risks increasing tax and legal uncertainty. The Commission should prioritise the harmonisation and strengthening of certain procedural and governance aspects of transfer pricing.
- 3** This needs to be supported by a more robust and efficient dispute resolution framework in the EU, including the streamlining of transfer pricing documentation requirements, promoting more use of Advanced Pricing Agreements, strengthening the Mutual Agreement Procedure in the Arbitration Convention, expanding the European Trust and Cooperation Approach (ETACA) initiative, and reinstating the EU Joint Transfer Pricing Forum.



DIRECTIVE ON TRANSFER PRICING

Background

On 12 September 2023, the European Commission published a Proposal for a Council Directive on Transfer Pricing to harmonise rules within the EU as part of its Business in Europe: Framework for Income Taxation (BEFIT) package.

To ensure that intragroup transactions are performed under commercial conditions, Article 9 of the OECD Model Treaty stipulates that these transactions should be priced in alignment with comparable dealings involving unrelated parties – a principle commonly known as the arm's length principle. The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ('OECD TP Guidelines') elaborate on the application of this principle.

Despite a political commitment to adopting the nonbinding OECD TP Guidelines, their current status and implementation vary across EU Member States. In this context, the Commission is aiming to harmonise transfer pricing rules across Member States, promoting a consistent application of the arm's length principle throughout the European Union. This objective is articulated through the proposed directive that seeks to incorporate the arm's length principle and key transfer pricing rules into the EU's legal framework.

The Commission intends to clarify the role and standing of the OECD TP guidelines within the EU, proposing the potential establishment of common binding rules on specific aspects of transfer pricing. To achieve this, it suggests introducing a common definition of 'associated enterprise' across the EU, defining the concept of the arm's length price, and specifying the transfer pricing methods permissible for determining the appropriate arm's length price. Additionally, the directive includes provisions related to comparability analysis, defining the arm's length range, and transfer pricing documentation.

The overall objective of the proposal is to increase tax certainty for multinational enterprises (MNEs) within the EU, thereby mitigating the risk of litigation related to transfer pricing arrangements and the risks associated with double taxation. The Commission also considers that the implementation of this proposal will reduce opportunities for MNEs to engage in aggressive tax planning practices through the use of transfer pricing.

The proposed directive would apply to all companies that are resident in an EU member state, and to permanent establishments situated within the EU. If adopted, the new rules would be implemented by 31 December 2025 and would apply as from 1 January 2026.



BusinessEurope's comments on the proposed rules

BusinessEurope acknowledges that the diverse transfer pricing rules and documentation standards across Member States are creating undue and costly administrative burden for businesses. On this basis, we welcome the Commission's efforts to simplify certain aspects of the transfer pricing rules to enhance tax certainty for businesses in the EU, reduce the risk of litigation and double taxation and the corresponding compliance expenses.

Nevertheless, the business community is apprehensive of the improvements to certainty or reduction of disputes that may be yielded through the proposed codification of the arm's length principle and the OECD guidelines into the EU's legal framework. Transfer pricing disputes generally arise due to diverging interpretations of the facts and circumstances of a case at hand rather than as a result of uncertainties as to how the existing guidelines should be interpreted.

The proposed codification of the arm's length principle and the OECD guidelines into the EU's legal framework therefore risks leading to **double, and potentially conflicting, standards**, particularly as the OECD guidelines are continuously being developed. This could potentially impose more risks in dealings with Third Countries. Furthermore, the diversity in local interpretations and industry practices may intensify challenges related to implementation and compliance.

In this respect, there are several specific concerns in the proposal that merit further attention:

- At the outset, it is unclear what the **intended duration of the proposed transfer pricing directive** is. Should a proposal for a formulary apportionment be adopted in the future, it raises the prospect of a diminished, if not entirely absent, application of the arm's length principle within the EU.
- Whilst the attempt to harmonise the definition of an "**associated enterprise**" has the potential to foster greater consistency and certainty in regulatory frameworks, the proposed 25% ownership threshold stands out as more stringent than the existing thresholds in many Member States and Third Countries, potentially harming the competitiveness of European companies in a global setting. We also expect this proposed threshold to bring into scope a number of commercial arrangements such as joint ventures carried out with independent third parties. It is unlikely such agreements made with third parties will be concluded on the same terms and at the same prices as other transactions within a group of companies, and this may give rise to an internal comparable which is inconsistent with the general transfer pricing policy of a company. Consequently, we expect this to lead to increased compliance for the number of transactions that will be subject to a transfer pricing analysis.



- Additionally, the clarification identifying a **permanent establishment as an associated enterprise** may pose practical challenges, particularly considering the divergence from the national tax laws of some Member States.
- The provision of practical guidance for implementing corresponding adjustments within an ambitious **180-day timeline** for cross-border transactions within the EU is a positive development. However, for this mechanism to effectively prevent double taxation, enhance cooperation among tax authorities, and ensure a more consistent application of the arm's length principle, **it is crucial for this timeline to be binding on tax authorities.**
- While it is proposed that the five common TP methods from the OECD TP guidelines are to be used to determine the arm's length price, the proposal introduces **a more rigorous requirement compared to the OECD guidelines.** It permits alternative valuation methods or techniques only if they yield results consistent with those achieved by third parties, with the added condition that taxpayers can demonstrate this.
- The proposal goes beyond the OECD TP guidelines by strictly endorsing an interquartile range, which tax authorities are generally restricted from adjusting unless a specific deviation within the range can be justified. While the effort to narrow down the acceptable range is deemed positive, experience shows that **transfer pricing disputes often relate to points within the interquartile range or regarding the benchmarks or the Profit Level Indicator used for establishing comparables.** Moreover, the proposal of allowing deviations when justified illustrates that **the primary source of disputes stems from divergent perspectives on the facts and circumstances of a particular transaction.** Consequently, businesses do not expect that codifying the range will curtail disputes. In contrast, it may result in more scrutiny of the taxpayer's benchmark study as tax authorities may or may not accept a profit that lies towards the lower end of the range, thus leading to locked positions on facts and circumstances and becoming unsustainable from a taxpayer's perspective. This will likely diminish flexibility in resolving disputes particularly in dealings with Third Countries.
- Whilst we recognise that the proposal's intention to incorporate additional rules in EU law aims for a flexible adaptation of the OECD TP guidelines through **Article 218(9) of the Treaty on the Functioning of the European Union,** concerns arise regarding the potential misuse of this procedure. Such misuse could lead to unintended consequences, including the imposition of more restrictive EU rules that may pose a disadvantage to businesses operating in certain Member States compared to others. It is important to carefully consider the implications to ensure that the proposed measures align with their intended purpose and do not inadvertently result in adverse effects on businesses and Member States.



In order to achieve increased tax certainty, reduce compliance costs and mitigate the risk of double taxation for cross-border intra-group transactions in the EU, we are putting forward our recommendations that should be prioritised in this directive:

- **Prioritising Procedural and Governance Enhancement**

We believe that the Commission's efforts aimed at transfer pricing simplification should prioritise the harmonisation and strengthening of certain procedural and governance aspects of transfer pricing.

In particular, streamlining transfer pricing procedures and documentation requirements (for example, adopting English documentation across all Member States, adopting standard templates for transfer pricing local files and master files, and employing pan-European benchmarks to determine the arm's length range) across Member States will foster greater consistency and tax certainty. This, in turn, should lead to the reduction of administrative burden and compliance costs and reduce the lengthy, controversial, and costly transfer pricing disputes for businesses operating within the EU.

- **Promoting the utilisation of Advanced Pricing Agreements (APAs) for dispute resolution**

Local tax authorities currently struggle to cope with the substantial volume of APAs. Consequently, taxpayers often opt to withdraw from procedures aimed at preventing and resolving disputes due to the protracted nature and significant commitment involved. Notably, the information requests associated with APAs can be as detailed as those in regular tax audits. This situation increases tax uncertainty and undermines cross-border business relationships, impeding economic growth.

In light of these challenges, promoting the adoption of APAs within well-defined timeframes and incorporating third-party arbiters for dispute resolution could strengthen the mechanisms for preventing and resolving disputes in the EU. This investment would serve to expedite the processing times of APAs, thereby increasing legal certainty for businesses operating in the EU.

- **Enhancing Accessible Dispute Resolution Mechanisms**

The presence of accessible and effective dispute resolution mechanisms is critically relevant to facilitate cross-border trade, ensuring tax certainty and eliminating double taxation for taxpayers. To this end, strengthening the use of mutual agreement procedures (MAPs) as outlined in the Arbitration Convention in the EU, through increased resources for tax administrations, can expedite case resolutions in shorter timeframes.



- **Expanding the European Trust and Cooperation Approach (ETACA) initiative**

The scope of the ETACA initiative should be expanded to cover not only low risk transactions but also include the review of transfer prices of specific intra-EU flows by participating Member States. This extension aims to foster a more comprehensive and effective approach to transfer pricing matters, particularly addressing joint tax audits where Member States may hold divergent views.

Furthermore, ETACA could play a pivotal role in developing harmonised guidance for practical aspects of transfer pricing. This includes offering clarity on the definition and procedural nuances of risk assessments and audits. Drawing inspiration from the OECD International Compliance Assurance Programme (ICAP), ETACA could be strategically linked with APAs and MAPs, thus serving as a fast-track solution for assessing and resolving transfer pricing issues.

- **Reinstituting the EU Joint Transfer Pricing Forum (JTPF)**

We believe it is also useful to leverage the insightful work accomplished by the EU JTPF, which, over its years of existence, has offered practical solutions to challenges posed by transfer pricing practices across Member States. Recognising the valuable guidance and recommendations from the JTPF, we propose the reinstatement of this forum, possibly with an expanded mandate. This would enable national experts from Member States and industry experts to provide support to the Commission and that may lead to legislation that can achieve the stated objective of increasing certainty for businesses in the EU.

- **Addressing challenges in the OECD Pillar One Framework**

We acknowledge the continuous efforts of the OECD within the Pillar One framework, specifically in relation to Amount B. This initiative aims to formulate a simplified transfer pricing approach for baseline marketing and distribution activities. Despite the inherently low risk associated with these activities, they remain a source of numerous disputes and it is expected that disputes will still arise at an EU level, given the differences in interpreting the chosen comparable.

In this context, and in order to reduce the compliance burden and increase tax certainty, we suggest the development of a safe harbour for low-risk activities and basic transactions (for example, management fees) coupled with a periodic review mechanism to ensure ongoing efficacy.

BusinessEurope will continue to make itself available to engage in a constructive dialogue with the European Commission to ensure that the development and specificities of the proposed rules are conducive to increased tax certainty and reduced litigation and double taxation risks.