ETAF feedback on the proposal for a Directive on Transfer Pricing

Representing the voice at EU level of 215 000 regulated tax advisers, the European Tax Adviser Federation (ETAF) is happy to provide its feedback to the European Commission on the proposal for a Directive transposing the OECD Transfer Pricing Guidelines into the EU legal order, published on 12 September 2023.

As preliminary remarks, we do recognise the importance of ensuring that all EU Member States apply the arm's length principle in a harmonised way to avoid profit shifting, double taxation, transfer pricing litigations and tax uncertainty.

The fact that each Member State has discretion in interpreting and applying the OECD Transfer Pricing Guidelines can indeed give rise to complexity and high compliance costs for companies. In this regard, we see the benefits of the proposal for businesses that have cross border transactions with associated enterprises.

However, it has to be recalled that the current flexibility is sometimes necessary to accommodate some national specificities, including by taking a stricter approach than the OECD in specific cases.

From our perspective, an EU Directive on Transfer Pricing should aim at giving clearer rules to businesses on the way forward. In particular, the main advantage of this initiative would be to make sure that simple and quick corresponding adjustments are accessible for taxpayers in case of transfer pricing corrections.

However, we find that most of the proposed provisions are to a large extent repetitions of the OECD Transfer Pricing Guidelines, some of them being mere repetitions with a different wording and others being unjustified aggravations compared to the OECD Guidelines.

To avoid ambiguities, interpretation difficulties and possible conflicts, we highly recommend staying as close as possible to the OECD Guidelines, by only referring to them, without re-wording them or going beyond.

I. Comments on the application of the arm's length principle

a. Definition of associated enterprises

Transfer pricing refers to the setting of prices for transactions between associated enterprises (i.e. members of the same multinational enterprise) involving the transfer of property or services. According to the OECD arm's length principle, transactions between associated enterprises must be priced on the same basis as transactions between third parties under comparable circumstances.

In the Commission's view, domestic legislations of Member States show differences in the definition of "associated enterprises" and in particular, on the notion of "control" which is normally the precondition to apply transfer pricing.

For this reason, the proposal seeks to introduce in article 5 a common definition of associated enterprise across the EU as a person who is related to another person in any of the following ways:

- a person participates in the management of another person by being in a position to exercise;
- a significant influence over the other person;
- a person participates in the control of another person through a holding that exceeds 25 % of the voting rights;
- a person participates in the capital of another person through a right of ownership that, directly or indirectly, exceeds 25% of the capital;
- a person is entitled to 25% or more of the profits of another person.

For the purpose of this Directive, a permanent establishment should also be treated as an associated enterprise.

We find the proposed definition rather broad and, consequently, we expect more enterprises and their transactions to fall under the scope of transfer pricing rules. This EU definition will definitely require the preparation of the necessary transfer pricing documentation for more transactions and will therefore increase the administrative burden for companies, rather than making it easier for them to carry out transactions in the internal market.

b. Corresponding transfer pricing adjustments

Where transactions are not conducted at arm's length, Member States are required to include the appropriate amount of profit that would have been included if the transaction were conducted at arm's length in the tax assessment and tax the additional profits. Where such a primary adjustment has been made in another jurisdiction, Member States must then ensure that they make a corresponding adjustment to prevent double taxation.

In particular, if double taxation has occurred, the proposal requires Member States to conclude the corresponding adjustment under a "fast track" procedure of maximum 180 days when there is no doubt that the primary adjustment is well founded or in case this results from a joint audit.

We support and welcome very much this provision set out in article 6, which will be extremely useful for relieving double taxation, reducing the number of cases referred to Mutual Agreement Procedures (MAP) and encouraging joint audits.

However, in order to make this provision more effective, we believe that an obligation to resolve the matter through an arbitration process should be stipulated, possibly within a slightly longer period of further 90 days. This should also be extended to Advance Pricing Agreements (APAs), provided that additional human resources are devoted.

Moreover, in our view, the tax authorities should not be given the option to refuse to make a corresponding adjustment on certain formal grounds, such as lack of documentation, since the same documentation was also sufficient for the other state to make the primary adjustment.

As a further relief measure for taxpayers, it would also be desirable to stipulate that it is the task of the state that has made the primary adjustment to arrange the corresponding adjustment. Such measure would significantly help reducing the administrative burden on companies.

c. Compensating transfer pricing adjustments

According to the proposal, Member States would also be obliged to accept a compensating transfer pricing adjustment initiated by a taxpayer in the form of a year-end adjustment if certain conditions are met.

Again, we believe that the requirements laid down in article 7 go beyond the OECD Transfer Pricing Guidelines. In our view, the requirement for the taxpayer to be able to explain why its forecast did not match the result achieved risks causing considerable legal uncertainty. For this reason, we believe this particular requirement should be withdrawn.

II. Comments on other harmonised elements

a. Delineation of the commercial and financial relations

In our view, the re-definition in article 8 of the delineation of the commercial and financial relations of the associated enterprises does not provide any added value and could rather risk generate interpretation difficulties. It would be preferable to simply have a reference to the OECD Transfer Pricing Guidelines.

b. Permitted transfer pricing methods

The proposal prescribes that the arm's length price is determined by applying the most appropriate transfer pricing method among the five predefined ones in the OECD Transfer Pricing Guidelines.

It further adds that any other valuation method can only be applied if it can be demonstrated in a satisfactory manner that none of the five methods is appropriate or workable in the circumstances of the case and that the selected valuation method provides a more reliable estimate of the arm's length result than the five other methods.

Here again, we would prefer a simple reference to the OECD Transfer Pricing Guidelines instead of the definition of EU requirements for the application and acceptance of certain methods and techniques. In particular, being obliged to prove that none of the five methods from the OECD Transfer Pricing Guidelines are appropriate will constitute a high burden for taxpayers.

c. Comparability analysis

The modalities for the comparability analysis set out in article 11 of the proposal differ from the OECD Guidelines. In particular, the margin given by the proposed EU rules is much more limited. We do not see any reason for this discrepancy which is expected to create difficulties in relation to non-EU countries.

d. Determination of the arm's length range

We find that article 12 is much stricter than the OECD Transfer Pricing Guidelines. Article 12 prescribes that where the application of the most appropriate method produces a range of figures, the arm's length range must be determined using the interquartile range (i.e. from the 25th to the 75th percentile of the results derived from the uncontrolled comparables).

It appears to us that the OECD Guidelines are indeed much more open to the applicability of the full arm's length range if the comparable entities have a high degree of comparability.

Moreover, we think that the statement that the tax authorities can also adjust results that are within the arm's length range if another point in the arm's length range can be justified in a specific case will lead to considerable legal uncertainty, increased transfer pricing adjustments and more double taxation conflicts and should therefore be rejected.

e. Transfer pricing documentation

The proposal also requires taxpayers to have sufficient transfer pricing documentation. The Commission is empowered to adopt delegated acts to specify the content of such documentation, by laying down common templates, setting linguistic requirements, defining the type of taxpayer to abide by these templates and the timeframes to be covered.

Although we expect that this provision could generate certain practical difficulties for Member States, we recognize that harmonisation and common templates would significantly reduce the tax compliance burden for the taxpayers.

In particular, a provision stating that transfer pricing documentation and supporting documentation in English must be accepted would be very welcome.

III. Establishment of future common rules

The proposal states that the latest version of the OECD Transfer Pricing Guidelines will be binding when applying the arm’s length principle in the Member States. As the OECD Transfer Pricing Guidelines will be amended from time to time, these new guidelines should be the new binding reference framework, it adds.

Moreover, it is proposed to establish further common binding rules in the area of transfer pricing by way of Council implementing acts, based on a proposal from the European Commission, for specific transactions defined in the Directive.

We believe that the choice of the above-mentioned decision-making process would go beyond the objectives of the proposal and we would recommend using the traditional legislative process on tax matters for establishing future common binding rules.

Notes
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About ETAF
The European Tax Adviser Federation (ETAF) is a European umbrella organisation for tax professionals whose activities are regulated by law. It is set as an international not-for-profit organisation (AISBL) governed by Belgian law, based in Brussels and was launched on 15th December 2015. It represents more than 215 000 tax professionals from France, Germany, Belgium, Romania, Hungary, Austria and Croatia. ETAF is a registered organisation in the EU Transparency Register, with the register identification number 760084520382-92.