CFE tax advisers europe

OPINION STATEMENT

Opinion Statement FC 10/2023 on the EU Commission Transfer Pricing Proposal

Issued by CFE Tax Advisers Europe
Submitted to the EU Institutions in December 2023

CFE Tax Advisers Europe is the European umbrella association of tax advisers. Founded in 1959, CFE brings together 33 national tax institutes, associations and tax advisers' chambers from 24 European countries. CFE was the initiator of the Global Tax Advisers Platform through which it is associated with more than 600,000 tax advisers worldwide. CFE is part of the EU Transparency Register no. 3543183647-05.

We would be pleased to answer any questions you may have concerning our Opinion Statement. For further information, please contact Bruno Gouthière, Chair of CFE Fiscal Committee, Jos Goubert, Chair of the Direct Taxes Subcommittee, or Aleksandar Ivanovski, Director of Tax Policy at info@taxadviserseurope.org. For further information regarding CFE Tax Advisers Europe please visit our web page http://www.taxadviserseurope.org/

CFE Tax Advisers Europe Office I 188A, Avenue de Tervueren, 1150 Brussels, Belgium
Tel. +32 2 761 00 92 I info@taxadviserseurope.org I www.taxadviserseurope.org

1. Background

On 12 September 2023, the European Commission proposed the Council Directive on Transfer Pricing. This proposal was launched at the same time as the proposal of the Council Directive "Business in Europe: Framework for Income Taxation (BEFIT)". The Transfer Pricing Directive integrates key transfer pricing principles into EU law, as part of the BEFIT package. Regarding the BEFIT Council Directive proposal, CFE refers to its Opinion Statement submitted in January 2023 and its Opinion Statement to be published in January 2024. The legal basis for this Transfer Pricing Directive is Article 115 of the Treaty on the Functioning of the EU. Therefore, the proposal is subject to the Council's unanimity for adoption, while the European Parliament only has an advisory role. If Member States reach an agreement, the Transfer Pricing Directive shall enter into force on 1 January 2026.

The current international standard, according to the Arm's Length Principle based on the OECD Transfer Pricing Guidelines, is that taxable profits or losses from domestic or cross-border transactions between related parties should be adjusted to reflect a situation with unrelated parties. This Arm's Length Principal has its legal basis in the OECD Transfer Pricing Guidelines. Although Member States have their own national legislation, it is mostly based to a greater or lesser extent on the at Arm's Length Principle.

The Transfer Pricing Directive intends to codify the Arm's Length Principle and the OECD Transfer Pricing Guidelines between the Member States, providing a framework into EU law and introduce processes for relieving double taxation for Multinational Entities. Besides defining the Arm's Length Principle, certain rules with respect to the selection and application of the appropriate transfer pricing method into EU legislation has been formulated. Further clarifications are given to the role and status of the Transfer Pricing Guidelines and introduces certain mandatory transfer pricing documentation requirements.

CFE welcomes the opportunity to contribute through ongoing engagement with the European Commission and European Parliament, in discussions in our role as a Member of the EU expert group, Platform for Tax Good Governance and Aggressive Tax Planning and via the public consultation process.

Given the degree of difficulty in finding a common ground concerning the reform of EU corporate taxation, our response does not necessarily represent the view of each and every Member Organisation of CFE, although reasonable efforts have been made to provide a coherent and representative view of European tax institutes and associations of tax advisers.

2. General Comments

Before proceeding with the drafting of the Transfer Pricing Directive proposal, CFE Tax Advisers Europe recommends that the following factors are taken into consideration by the European Commission:

- According to the current international standards, which have been developed by the Organisation for Economic Cooperation and Development (OECD), (cross-border) transactions between related entities of a multi-national group must be priced on the same basis as transactions between third parties under comparable circumstances. This is known as the 'Arm's Length Principle' and is reflected in article 9 (Associated Enterprises) of the OECD Model Tax Convention on Income and on Capital.

- However, article 9 does not set out detailed transfer pricing rules. Over time the OECD has developed the OECD Transfer Pricing Guidelines for Multinational Enterprises and tax administrations (so-called 'soft law') which provides guidance on the meaning and application of the Arm's Length Principle. Those guidelines have been developed as a non-binding instrument with the aim to assist Multinational Enterprises and tax authorities in finding solutions to transfer pricing cases that minimise conflicts and limit litigation.

- Article 9 of the OECD Model Convention is not considered to create a domestic transfer pricing regime if the Arm's Length Principle has not been incorporated in the national law. It does however already provide jurisdictions with the possibility to impose a tax adjustment.

- The rationale of this proposal derives from the fact that almost all Member States are also members of the OECD and, therefore, are committed to follow the OECD principles and recommendations. However, despite the political commitment by the majority of Member States, the status and role of the OECD Transfer Pricing Guidelines currently differs from Member State to Member State. In addition, at the level of the Union, transfer pricing rules are currently not harmonised through legislative acts, although all Member States have in place domestic legislation that provides for a common approach to the basic principles. Yet, this is not fully aligned. The fact that each Member State enjoys large discretion in interpreting and applying the OECD Transfer Pricing Guidelines gives rise to complexity and an uneven playing field for businesses.

- The risk of double taxation and over-taxation for businesses operating cross-border leads to a lack of tax certainty due to possible tax disputes between tax administrations of different Member States in cases where they take different views in relation to the treatment of a specific transaction within their corporate tax system. In a continuously more globalised and competitive world economy, there is an increased need for more

tax certainty in the Single Market. Thus, to increase tax certainty regarding their tax affairs, some businesses seek to obtain tax rulings from a tax authority in respect of the treatment of certain transactions.

- The complexity of the transfer pricing rules and their different implementation in the national law of Member States gives rise to a number of other problems, including:
  - Profit shifting and tax avoidance;
  - Litigation and double-taxation;
  - High compliance costs.

- These tax barriers for businesses impede the proper functioning of the Single Market and hamper the prospect for achieving its potential in terms of efficiency gains. As a result, the competitiveness of the Single Market is undermined.

- The Transfer Pricing Directive sets a goal by laying down rules to harmonise the key transfer pricing principles across the EU, aims to increase tax certainty, reduce compliance costs, and mitigate the risk of double (non) taxation. Member States currently have significant discretion in interpreting and applying the OECD Transfer Pricing Guidelines for Multinational Enterprises and tax administrations. According to the European Commission this brings tax barriers which undermine the competitiveness of the Single Market. The Transfer Pricing Directive seeks to harmonise transfer pricing norms within the EU through the incorporation of the Arm's Length Principle into EU law and the clarification of the role and status of the OECD Transfer Pricing Guidelines.

- This proposal aims at simplifying tax rules through increasing tax certainty for businesses in the EU, thereby reducing the risk of litigation and double taxation and the corresponding compliance costs and thus improve competitiveness and efficiency of the Single Market. A clear outcome from both the targeted and public consultations was the desire of business for tax, and more broadly, legal certainty. Tax certainty has always been a high priority for business, often highlighted as a more important concern than the tax rate. This has become an increasingly critical issue due to the vast number of ambitious reforms in international corporate taxation over the recent years.

- This objective is achieved by:
  - Incorporating the Arm's Length Principle into Union law;
  - Harmonising the key transfer pricing rules;
  - Clarifying the role and status of the OECD Transfer Pricing Guidelines; and
  - Creating the possibility to establish, within the Union, common binding rules on specific transfer pricing subjects within the framework of the OECD Transfer Pricing Guidelines.

- The proposal would provide a gradual development of common and consistent approaches among Member States' tax authorities to the interpretation and application

of transfer pricing rules through the incorporation of the Arm's Length Principle into Union law and the clarification of the role and status of the OECD Transfer Pricing Guidelines. Furthermore, the prospect for establishing common binding rules for Member States on specific transactions within the framework of the OECD Transfer Pricing Guidelines should improve businesses' resilience in the Union, reduce distortions and contribute towards a level playing field in the Single Market.

- The Transfer Pricing Directive would benefit businesses in the internal market by adopting a common standard to address intercompany transactions, thus:
    - Reducing situations where peculiarities in Member States' legislation could harm the functioning of the internal market and lead to double-tax situations; and
    - Providing certainty on some important sources of disagreement between EU Member States.

- This being said, the European Commission mentions that codifying transfer pricing guidelines into EU law could eventually increase tax certainty, including through the case law of the European Court of Justice. On the other hand, in some respects, the rules would be stricter than the OECD Transfer Pricing Guidelines and Member States would be required to depart from some of their existing practices, which may impact their support for this proposal. This is one of the main reasons for CFE to oppose the introduction of specific, EU-imposed transfer pricing rules. This stricter regulation brings another set of transfer pricing guidelines into play, which would sit alongside national legislation and the OECD Guidelines themselves. Although CFE is in favour of increased tax certainty, the Transfer Pricing Directive could bring the opposite result. Restricting existing options for profit allocation and transfer pricing methodology as set out by the OECD Transfer Pricing Guidelines would represent a new interpretation of the Arm's Length Principle which could lead to uncertainty, higher compliance costs and disputes.

  A few examples can be given:
    - The Transfer Pricing Directive uses a broader term of 'associated enterprises' than certain Member States and may therefore increase the number of transactions that have to comply with the OECD Transfer Pricing Guidelines. The 25% threshold, in particular, establishes another criterion for defining a group from those contained in the draft BEFIT Directive and Pillar Two, with coordination issues potentially arising.
    - Another difference can be found in the definitions in the Transfer Pricing Directive regarding permanent establishment, which is described as a 'fixed place of business' based on the respective tax treaty. This permanent establishment definition seems more restrictive than the definition in most tax treaties that also cover for example dependent agent permanent establishments.

- CFE supports simplification, but it is not in favour of the parallel standards proposed by the Transfer Pricing Directive, which makes legal relationships intra-EU versus non-EU more complicated. By introducing a new set of rules the aim of simplification is not met. Furthermore, to say the least, it is very challenging to codify the dynamic and evolving OECD Guidelines in EU legislation that will be implemented in the different national legislations of the Member States. This begs the question as to whether this Transfer Pricing Directive is the right instrument for the task and is proportional from a legislative point of view. Article 5(3) of the Treaty on European Union provides: *"Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level."* In this case a soft law approach is perhaps more appropriate taking into account the realities of today's economic and global developments when allocating the tax base to Member States. Perhaps the Member States involved should join the OECD for this perspective.

- Regarding the documentation requirements, introducing mandatory transaction-level transfer pricing documentation may result in an additional burden for certain taxpayers given some Member States currently do not impose OECD based local file documentation. CFE believes that harmonisation on this point could be helpful, but common templates should not go beyond Local File requirements.

- If the directive enters into force, it may have a major impact on large-scale groups operating in the EU, as it creates a new framework of EU tax rules (again). Certainty is fundamental for every legal system. The directive introduces a lot of adjustments and needs to be more coherent with related directives, for example with BEFIT (we refer to CFE's Opinion Statement anticipated to be published in January 2024 in this respect as well).

- Please be aware that administrations of many Member States are not able and capable (yet) to implement all launched initiatives on time. From this perspective it is often seen that the legislators of the Member States increasingly choose to opt for average implementations with reference to the guidelines, as in this directive, thereby passing on the necessary uncertainty to the tax payers involved, which is undesirable in any legal system and which directly contradicts the goal of the proposed directive.

- This also raises the argument how the rights of the taxpayers will be preserved within the complexity of different frameworks and different interpretations regarding filings and administrations. At this point the taxpayers' positions are not yet guaranteed.

3. Scope & Implementation

- If the Transfer Pricing Directive is adopted it shall then enter into force on 1 January 2026. Regarding this timeframe, CFE feels compelled to remark explicitly that it is very short given the implications for the Member States and the enterprises involved. Furthermore, this directive introduces a lot of legislative adjustments and needs to be more coherent in the broader perspective, and we refer to our Opinion Statement BEFIT to be published in January 2024 in this regard. Also, CFE is of the view the administrations of Member States are not able and capable (yet) in following all launched initiatives on time, often choosing instead to opt for average implementations with reference to the Guidelines, which in the end creates legal uncertainty (also in respect to their rights) for the taxpayers and enterprises involved.

- The legal basis for the Transfer Pricing Directive is article 115 of the Treaty on the Functioning of the EU, which requires unanimity in the Council before the directive can be adopted. Provided that Member States reach an agreement, they should take the necessary steps to comply with the directive by 31 December 2025. The Transfer Pricing Directive shall then enter into force as per 1 January 2026. The directive purports to harmonise transfer pricing rules of Member States and to ensure a common application of the Arm's Length Principle within the EU, making the OECD Transfer Pricing Guidelines become part of legislation. When adopted, the Transfer Pricing Directive will apply to all taxpayers that are registered or subject to tax in one Member State.

- As mentioned, the legal basis for legislative initiatives on taxation is article 115 of the Treaty on the Functioning of the European Union (TFEU). Although no explicit reference to direct taxation is made in this article, it does refer to issuing directives for approximating national laws that directly affect the establishment or functioning of the Single Market. It follows that, under article 115 TFEU, directives are the appropriate legal instrument for the Union in this field. Based on article 288 TFEU, directives will be binding as to the result to be achieved upon Member States but leave the choice of form and methods to the national authorities.

- In accordance with the subsidiarity principle laid down in article 5 of the Treaty on the European Union, action at Union level should be taken only when the aims envisaged cannot be achieved sufficiently by Member States acting alone and in addition, by reason of the scale or effects of the proposed action, can be better achieved by the Union. The cross-border nature of the problem at stake requires a common initiative across the Single Market. Since transfer pricing is inherently cross-border in nature, it can only be tackled by laying down legislation at Union level, in the opinion of the European Commission. This initiative, from the European Commission point of view, should therefore be in line with the subsidiarity principle, considering that individual

uncoordinated action by the Member States would only add to the current fragmentation of the legal framework for transfer pricing and fail to achieve the intended results. A common approach for all Member States would have the highest chances of achieving the intended objectives. A legislative initiative should therefore be in accordance with the principle of subsidiarity, as set out in Article 5 of the Treaty on the European Union.

- The envisaged measures should also not go beyond the minimum necessary level of protection for the Single Market and therefore, are compliant with the principles of proportionality. The directive ensures a common approach with regard to core transfer pricing principles and provides targeted rules for specific transactions where most added value for the Union can be created. A common Arm's Length Principle standard and a more harmonised approach towards transfer pricing should result in a less fragmented application and interpretation of the arm's length principle across the Union which should reduce disputes, litigation and the overall compliance costs for businesses operating across the Union. In light of this, the proposal for a directive does not go beyond what is necessary to achieve its objectives and is therefore compliant with the principle of proportionality, in the opinion of the European Commission.

- That being said, CFE supports simplification, but it is not in favour of parallel standards which is proposed by the Transfer Pricing Directive. This directive makes legal relationships intra- EU versus non-EU more complicated. Furthermore, to say the least it is very challenging (if not contrary to rule of law principles) to codify the dynamic and evolving OECD Guidelines in EU legislation that will be implemented in the different national legislations of the Member States.

- In addition, CFE notes that the parallel standards may evolve differently which will result in an increase of complications and disputes. On the basis of the directive, the ECJ would be competent. The draft however does not set out stipulations for different forums for transfer pricing disputes to be resolved, in particular in relation to States outside the EU.

- This begs the question of whether the Transfer Pricing Directive is the right instrument for the task and is proportionate from a legislative point of view. Article 5(3) of the Treaty on European Union provides: "*Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.*" To assist national parliaments in their evaluation of subsidiarity compliance, article 5 of Protocol (No 2) on the application of the principles of subsidiarity and proportionality states: "*Any draft legislative act should contain a detailed statement making it possible to appraise*

compliance with the principles of subsidiarity and proportionality. This statement should contain some assessment of the proposal's financial impact and, in the case of a directive, of its implications for the rules to be put in place by Member States (…).” In this case, a soft law approach is perhaps more appropriate taking into account the realities of today’s economic and global developments when allocating the tax base to Member States. Perhaps the Member States involved should join the OECD for this perspective. From this point of view, CFE would question whether the Transfer Pricing Directive is truly necessary.

4. Burden on Business

The Transfer Pricing Directive introduces another set of transfer pricing rules, next to the national ones and the OECD Guidelines themselves. Also, a further alignment with other legislative initiatives, such as BEFIT, needs to be made. The directive adopts a stricter approach regarding the Arm’s Length Principle range than the OECD Guidelines, when the application of a transfer pricing methodology produces a range of values. The Transfer Pricing Directive prescribes that Member States may only make adjustments if the results fall outside the (interquartile) arm’s length range, unless it is proven that a different positioning within the range is justified by the facts and circumstances of the specific case. If an adjustment is made, it should be made to the median, unless it is proven that a different positioning in the range is justified by the facts and circumstances of the specific case.

Regarding the documentation requirements, introducing mandatory transaction-level transfer pricing documentation may impose an additional burden on certain taxpayers as some Member States currently do not impose OECD based local file documentation. CFE believes harmonisation on this point could be helpful, but common templates should not go beyond Local File requirements. Furthermore, the Commission shall be empowered to further supplement the rules of the directive with regard to documentation. This would be done by laying down common templates, setting linguistic requirements and defining the type of taxpayer to complete these templates and the timeframes to be covered, further harmonising the applicable transfer pricing rules throughout the EU. This would create additional uncertainty in the opinion of CFE.

If the directive enters into force, it may have a major impact on large-scale groups operating in the EU, as it creates a new framework of EU tax rules. Member States will have to include the provisions of the Transfer Pricing Directive in their national legislation. This new framework within the EU would require multinational enterprises active in Member States to review whether their transfer pricing policies need to be adjusted. In addition, their current documentation may have to be adjusted where necessary to comply with the new rules.

5. Conclusions

From the point of view of taxpayers and Member States, it is important to maintain 'balanced allocation of taxing rights' for Member States to guarantee their current tax revenues. If the imbalance in taxing rights would result in an increase in domestic tax rates in the longer term, it would be considered an unwanted consequence. That said:

- CFE supports simplification, but it is not in favour of parallel standards as proposed by the Transfer Pricing Directive. This directive makes legal relationships intra-EU versus non-EU more complicated. Furthermore, it would be extremely challenging to codify the ambulatory, dynamic and evolving OECD Guidelines in EU legislation that would need to be implemented in the different national legislations of the Member States. Therefore, CFE considers that the legal basis of the Transfer Pricing Directive is not in line with the EU law, is not in line with the subsidiarity principle, and is therefore disproportionate. CFE is of the view that the explanations and formulations given by the European Commission do not adequately satisfy the legal basis and do not demonstrate that the aims of the initiative cannot be sufficiently addressed by Member States themselves. This argument is apparent in several of the legal initiatives from the EU that have been rolled out at breakneck speed.

- The timeframe outlined is very short given the impact on Member States and the enterprises involved. The directive introduces a lot of legislative adjustments and should be more coherent in its broader perspective. Furthermore, the administrations of Member States are not able and capable (yet) of implementing all launched initiatives on time, often choosing instead to opt for average implementations with reference to the guidelines, as is also the case regarding this directive, which in the end would create legal uncertainty (also in respect to their rights) for the taxpayers and enterprises involved.

- The administrative costs for the enterprises involve should not be underestimated.

CFE and its Member Organisations stand ready to assist the Commission in considering the issues above in the course of the policy dialogue and public consultation.