



# EU Transfer Pricing

## BEFIT- Proposal on Transfer Pricing

September 2023



### Summary

On September 12, 2023, the EU commission unveiled the much awaited proposal on “*Business in Europe: Framework for Income Taxation*” (“BEFIT/ BEFIT corporate tax proposal”)<sup>1</sup>, which lays down a common set of rules for computing the tax base for EU group companies (“BEFIT Group”), having a combined annual turnover exceeding EUR 750 million and where the ultimate parent entity holds at least 75% of the ownership rights or of the rights giving entitlement to profit.

As part of the BEFIT, the commission issued a second separate proposal on Transfer Pricing (“TP Proposal”/“Proposal”) to harmonise the Transfer Pricing regulations across the EU states, which is also consistent with the implementation of OECD/G20 Inclusive framework Two Pillar Solution and is applicable to all MNE Groups operating in EU.

It is to be noted that while the TP proposal is substantive, the BEFIT corporate tax proposal also lays down important regulations relating to simplification of TP compliance procedures for certain activities. Hence both the TP proposal and BEFIT corporate tax proposal in so far as it relates to Transfer pricing, will need to be read in conjunction.

The common framework is expected to create a level playing field, enhance legal certainty, reduce compliance cost, encourage businesses to operate cross-border and stimulate investments and growth in the Union.

This article highlights the key facets of the TP Proposal and BEFIT Corporate Tax proposal in relation to Transfer Pricing.

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<sup>1</sup> Replaces the Commission's CCTB (common corporate tax base) and CCCTB (common consolidated corporate tax base) proposals, which stand withdrawn.



## Background

The complexity of the transfer pricing rules and their varied interpretation by each of the EU Member states led to-

- high risk of double taxation and over taxation for businesses with cross border transactions,
- tax uncertainties due to different views adopted by each EU member state on a specific transaction;
- profit shifting and tax avoidance; and
- high legal and compliance cost.

These tax barriers posed as serious impediments to businesses operating in the EU region hampering the competitiveness and growth of the Single Market.

Thus it became crucial to address the above deterrents in light of the ambitious reforms in international corporate taxation over the years. With this objective in mind the EU commission issued the BEFIT Transfer Pricing proposal which:-

- incorporates the arm's length principle into the Union Law;
- harmonises the key transfer pricing rules;
- clarifies the role and status of the OECD TP guidelines; and
- creates the possibility to establish, within the Union a common binding rule on transfer pricing subjects within the OECD TP framework.



## Scope of the TP Proposal

The TP Proposal is divided into 3 segments encompassing:-

- Part 1: Arm's length Principle and consequences of applying the principle
- Part 2: Core elements relevant for applying the arm's length principle
- Part 3: Mechanism for establishing further common rules for simplification and tax certainty

The TP Proposal is designed to be in consensus with existing EU policies like anti-tax avoidance directive (ATAD), directive on administrative cooperation (DAC) and in particular DAC3 and DAC6 which are of particular relevance due to their connection with TP.

It is imperative to note here that the scope of the TP Proposal differs from that of the BEFIT proposal to the extent that TP Proposal is applicable to all MNE groups operating in the EU i.e. it applies to a broader scope of entities as compared to BEFIT.



## TP Proposal

The TP Proposal is by far in line with the OECD TP guidelines with regard to the determination of the related party transactions, TP methods including the selection and application of the methods; determination of arm's length price/quartile range. The key aspects for consideration are provided below:

## **1. Harmonization of TP Regulations and Documentation requirements**

Currently the transfer pricing rules are not harmonized by legislative acts at the Union level, leading to disparity amongst Member States in interpreting various terminologies like for e.g. definition of AE, notion of “control” etc. This also acts as an attributing factor to have a single unified regulation and to curb the current issues in transfer pricing arena faced by EU nations.

The key reform of this proposal is the harmonisation of the Transfer Pricing Regulations and documentation requirements across the EU states which is likely to bring down the compliance cost significantly for businesses apart from addressing the above mentioned deterrents to Transfer Pricing in EU. The Proposal further empowers the commission to define common templates, setting linguistic requirements, defining the type of taxpayer to abide by these templates and the timeframes to be covered with respect to the preparation of the transfer pricing documentation.

The proposal further lays down that the Member states shall be governed by the OECD guidelines as may be updated from time to time.

## **2. Corresponding, Compensating and Downward Adjustments**

Corresponding adjustments are made in response to a primary adjustment and aim at eliminating any double taxation which may occur as a result of a primary adjustment. In fact, when a tax administration increases a company's taxable profits in one tax jurisdiction (by means of a primary adjustment), a corresponding adjustment may be necessary in order to lower the tax liability of that company in the second tax jurisdiction involved. The proposal sets forth comprehensive rules relating to corresponding adjustments with a view to eliminating any double taxation arising as a result of primary adjustment.

Voluntary adjustments made by the taxpayer before the company's tax return is filed are known as compensating adjustments. In respect of compensating adjustments, the proposal seeks to establish a common approach within the Union by laying down the conditions under which Member States should recognise a compensating adjustment. This provision is to be interpreted in conjunction with the Commission's 2013 EU Joint Transfer Pricing Forum Report on compensating adjustments. The said directives are bound to reduce litigations and also address the burden of double taxation arising out of compensating adjustments.

The proposal also authorises the Member states to perform a downward adjustment, in the absence of primary adjustment subject to certain conditions.

Further it also introduces a fast track mechanism to facilitate Member States to grant corresponding adjustments within 180 days, particularly in cases where primary adjustment is well founded or in case of joint audits.

Thus the proposal aims to swiftly resolve and addresses issues of double taxation and double non taxation, thereby promising tax certainty to businesses, promoting a competitive growth environment.



**BEFIT Proposal (Corporate Tax)**

While the TP proposal is substantive, it is pertinent to note that the BEFIT proposal on corporate tax should also be read and applied in conjunction with the TP Proposal. The BEFIT proposal also lays down certain regulations aimed at simplifying transfer pricing compliance procedures for certain activities.

**Introduction of Traffic Light System for low risk activities under BEFIT**

The transactions between BEFIT group and associated entities outside the BEFIT group will continue to be governed by the arm’s length principle. However, the BEFIT proposal provides for a simplified risk assessment framework, that is applicable to low-risk activities as defined in Article 50 i.e. low risk distributors and contract manufacturers who do not hold any intellectual property rights or any risk related to the products.

In respect of these activities, BEFIT suggests using “Public Benchmarks” as profit markers set at the Union level. The risk zone shall be determined using the interquartile range of the 5-year average profit performance of independent entities resulting from the public benchmarks. It requires the Member states to follow the below risk framework:

Risk zone	Profit performance of the tested party relative to the EU profit markers
<b>Low</b>	above 60TH percentile of the results of the public benchmark
<b>Medium</b>	below 60TH percentile but above the 40TH percentile of the results of the public benchmark
<b>High</b>	below the 40TH percentile of the results of the public benchmark

Accordingly, if the profit performance of a low-risk distributor or contract manufacturer is below the 40<sup>th</sup> percentile of the results in the public benchmark, its transactions will be assessed as ‘high-risk’. This way, the transactions will be categorised into three risk zones (low/medium/high), facilitating the Member State tax administrations to focus their efforts on the high-risk zones.

This feature of BEFIT focuses on simplifying compliance with transfer pricing and does not interfere with the substantive rules that determine whether a certain transaction has been priced at arm’s length, which is laid down in the TP Proposal.



## Implementation Timeline

Once the proposal is approved by the council, it shall come into force with effect from *January 01, 2026*. The application of this Directive will then be examined and evaluated by the Commission every 5 years.



## Conclusion

The EU Commission's proposal on TP Regulations is likely to place the EU Member states in par with the international best practices, promising an environment of tax certainty coupled with elimination of critical tax burdens like double taxation and double non taxation. Harmonisation of Transfer Pricing regulations across the EU member states offers promising benefits in terms of reduction in compliance and litigation costs which is likely to be an impetus for achieving sustainable growth and a competitive single market.

Further synchronizing the TP documentation requirements across EU states is likely to address the drawbacks in the current TP system.

Likewise MNE's will need to proactively align their businesses and strategies to meet the requirements of the new directives and be best equipped to meet the challenges likely to arise in the transitional phase of implementation.

### About us



VSTN Consultancy Private Ltd is a boutique Transfer pricing firm with extensive expertise in the field of international taxation and transfer pricing.

Our offering spans the end-to-end Transfer Pricing value chain, including design of intercompany policy and drafting of Interco agreement, ensuring effective implementation of the Transfer Pricing policy, year-end documentation and certification, BEPS related compliances (including advisory, Masterfile, Country by Country report), Global Documentation, safe harbour filing, audit defense before all forums and dispute prevention mechanisms such as Advance Pricing agreement.

We are structured as an inverse pyramid where leadership get involved in all client matters, enabling clients to receive the highest quality of service.

Being a specialized firm, we offer advice that is independent of an audit practice, and deliver it with an uncompromising integrity.

Our expert team bring in cumulative experience of over five decades in the transfer pricing space with Big4s spanning clients, industries and have cutting edge knowledge and capabilities in handling complex TP engagements.



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