Transfer Pricing and State Aid in the EU: an OECD Perspective

IFA-YIN Conference

May 2016
Agenda

1. Setting the scene
2. Concept of Transfer Pricing
3. State aid rules
4. “Relationship” between the State Aid Framework and the OECD Transfer Pricing Rules?
The key to EU Tax Harmonisation?
“One should be taxed by law, and not be untaxed by concession”  

*J. Walton in Vestey v IRC [1980] AC1148*
What will we be talking about?
The current global environment

BEPS
State aid & Transfer pricing
Dates back to the 90’ies, but intensified after 2000
Budgetary difficulties

Transparency & reporting initiatives
Tax Morality debate
Tax competition & incentives
Media and civil society attention

State aid

Dates back to the 90’ies, but intensified after 2000

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PwC
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The debate on where to tax profits...
A long history and seasoned principles

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The arm’s length principle... a continuing debate

“My arm hurts.”
“(...) Transfer Pricing is not an exact science but does require the exercise of judgment on the part of both the tax administration and taxpayer.” The OECD Guidelines 1005, Paragraph 1.12.
It is all about...

The ‘Mobile Company’ Inc

Arm’s length?

Arm’s length?

...pricing
Finding arm’s length comparables
Transfer Pricing process

- Gathering background information
- Functional analysis
- Benchmarking study
  - Quantitative and qualitative criteria to include or reject potential comparables (OECD TP guidelines para 3.43)
- Industry analysis
- Economic analysis
- Financial analysis
- Legal analysis
3/State aid rules

“The main reason behind our state aid action is the realization that governments can distort competition in the Single Market not only by granting subsidies but also by offering sweetheart tax deals.” Comm. Almunia, 2014.
The EU “Fiscal” State Aid debate
Combatting tax competition or ...?

Article 107(1) TFEU

“Save as otherwise provided in the Treaties, any aid granted to a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.”

There is no separate definition for Fiscal State Aid
Status of the main recent fiscal State aid investigations

Apple
11.06.2015
Pending Investigation

Belgian Excess Profit
11.01.2016
Recovery Decision
APPEALED

Starbucks Coffee
21.10.2015
Recovery Decision
APPEALED

FIAT
21.10.2015
Recovery Decision
APPEALED

Amazon
07.04.2014
Pending Investigation

McDonald’s
03.12.2015
Pending Investigation
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“I will take swift and decisive action against breaches of the rules, as in the case of the EU-wide investigation on tax rulings (...). We have to find out what the precise decisions were in these individual cases and learn from them.” Comm. Vestager, 2014.
State Aid vs. Transfer Pricing

Analysis as proposed by the EC in the State aid assessment:

- Reference framework: National CIT system
- Principle of equal treatment in fiscal matters
- Does TP method chosen to establish prices lead to the market result/ does it reflect commercial value (preference for CUP)?
- Comparables: multinational companies and stand-alone companies

OECD TP approach:

- Reference framework: OECD TP Guidelines and Article 9 OECD MTC (“Soft law” unless implemented in tax treaty)
- Arm’s length principle
- Does TP method chosen lead to an arm’s length result?
- Comparables: benchmark study (quantitative and qualitative criteria to include or reject potential comparables (para 3.43))
- Full comparability analysis including factual and functional analysis
Breaking point in the evolution?
EU “arm’s length principle”

EC’s Notice on the application of State aid to direct taxation & Code of Conduct for Business Taxation

No aid if: (i) tax measures of a purely technical nature, or (ii) pursuing general economic policy objectives.

Gentlemen’s agreement to refrain from introducing any harmful tax measures, which may affect the location of business activity in the EU, and which provide for significantly lower level of taxation from that generally applicable in the Member State concerned.

The EC analysis of the cost plus method: this method leads to systematic use of low or default margins and the exclusion of certain expenses from the cost of the centre.

In principle, nothing is wrong with the cost plus method, unless it is applied incorrectly, or other TP method(s) could be used (e.g. preference CUP).

CUP method is always preferred, as it leads to the most reliable result to establish the arm’s length price.

The EC seems to suggest that when there is lack of comparable independent enterprises on the market which would have agreed on making the same or similar payments, and the CUP method cannot be applied due to lack of sufficient data, transaction at stake should be disregarded?
Country A may be of the view that they should tax the interval a-b’
Country B may be of the view that they should tax the interval c’-d
Views over which interval each country may tax may be different and may even lead to overlapping intervals
It can also happen that certain parts are left untaxed.

“The arm’s length principle is sound in theory since it provides the closest approximation of the workings of the open market […]. This reflects the economic realities of the controlled taxpayer’s particular facts and circumstances and adopts as a benchmark the normal operation of the market’. (Para. 1.14 OECD TPG).
Key technical discussion points in the ongoing State aid investigations

1. OECD vs EU rules vs Domestic rules
   - Is the reference framework applied by the EC correct?

2. Tax treaties vs State aid rules
   - Do State aid rules overrule tax treaty rules?

3. Difference stand alone company vs MNC = State aid?
   - Is a stand alone company comparable to a MNC?

4. CUP method vs other TP methods
   - CUP as the default method?
Thank you!

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