

Summary and conclusions

Belgium does not exactly have a stellar reputation for taking novelty positions on inter-company pricing for intangibles. The question, though, is whether this is in any way bad news. Indeed, transfer pricing, and especially that relating to intangibles, is a subject that is highly fact driven. The Belgian tax authorities, including the service for advance decisions, appear to lay the emphasis on “keeping one’s business head on” when dealing with the matter, and the reporter feels that this is good news. This means that grasping and documenting how enterprises operate is key. Consequently, one should have an understanding of how tasks are divided. Getting to grips with where people who are “capable of credibly managing risk” operate, what risks are inherent in the business, what the level of integration is, etc. is key prior to actually selecting a transfer pricing method and “doing the number-crunching” for setting royalties and any other charge for the transfer or use of intangibles. Confusion or even controversy over inter-company dealings on intangibles is likely to be avoided when the taxpayer keeps a robust paper trail on functional analysis. In this way, he can “exploit” the benefit of:

- the absence of truly hard and fast rules on transfer pricing;
- acknowledgement by the courts that the matter is so “intangible” that, when dealing with litigation, one should be emphatic as to the difficulties surrounding intangibles;
- the fact that, in its efforts to attract foreign investors through the principle of granting what in common parlance can be called “excess profit” advance pricing agreements (APAs), Belgium implies that a balanced “assertiveness level” approach can be expected in the tax authorities’ screening of inbound versus outbound transactions;
- Belgium’s reliance on the OECD guidelines, which acknowledge that transactions take place in a controlled situation that are unlikely to take place at arm’s length. (For instance, it is doubtful whether there are real-life cases showing distributors spending money to enhance another party’s trademarks.)

One should beware not to paint too rosy a picture of how the tax authorities deal with the matter. Since late 2004, an increasing number of internationally operating entities in Belgium have received an in-depth transfer pricing questionnaire,

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also covering intangibles. Some of these audits result in tense encounters with e.g. the recently set-up specialist transfer pricing investigation squad, which tends to be inundated with applications simply from the high-margin sectors such as pharmaceuticals, cosmetics or specialty chemicals in general, or firms in the service industry marked by high added-value services. Economic ownership is particularly screened and, in analysing the contribution of intangibles to income, not only is the value of patents and proprietary knowhow screened but also the value embedded in processes, networks of employee knowledge, etc. and even the value chain “universe” including corporate management, production, R&D and selling.

Experience in litigation is fairly limited and it often tends to conclude in favour of the taxpayer. The reporter has not found cases resolved under the aegis of mutual agreement or arbitration, and therefore pushing the envelope of what might happen in such instances would probably only be speculation.

In the current state of play, the Belgian APA Commission, especially since beefing up its competences and revisiting its approach since early 2005, proves to offer an effective means to avoid litigation by way of (unilateral) APAs. The experience on a multilateral front is probably insufficient to draw robust conclusions at present.

In general, on the recommended methodologies, the arm’s length character of intangibles transactions among affiliates is primarily to be checked under the comparable uncontrolled price (CUP) method, in line with the OECD guidelines. As a CUP tends to be more the exception than the rule, the analysis may be based on an economic analysis of the respective returns expected by the transferor and transferee, compared to their respective efforts for the development and exploitation of the intangible. Consequently, in the reporter’s view profit methods merit more than the “last resort” status that the OECD guidelines have allotted to them, and it appears as if this is accepted in a Belgian context. At the end of the day, approaches based on sound principles of financial economics may offer convincing evidence of taxpayers’ attempts to refrain from artificial profit shifting while struggling with the extremely difficult matter of pricing intangibles.

1. Introduction

1.1. Overview of the transfer pricing taxation system

The arm’s length standard was only introduced into Belgium by a law of 21 June 2004.¹ At the same time, Belgian APA practice was revisited. As a result of the introduction of section 185(2)(a) of the Belgian Income Tax Code (ITC), the arm’s length principle as laid down in article 9(1) of the OECD model convention has been translated into Belgian law.²

The provision applies to:

¹ Belgian Official Gazette of 9 July 2004; entry into force on 19 July 2004.

² Circ. no. Ci.RH.421/569.019 (AOIF 25/2006) dated 4 July 2006.

- a Belgian and a foreign company that belong to a multinational group of dependent companies;
- a Belgian and a foreign permanent establishment of a company of the same multinational group of dependent companies;
- a Belgian company and a foreign permanent establishment of another Belgian company that belong to the same multinational group of dependent companies;
- a Belgian permanent establishment and its foreign head office; and
- a Belgian permanent establishment and a foreign permanent establishment of the same company located outside the head office country.

A multinational group of dependent companies is to be interpreted in a company law context and comprises:

- (a) companies over which control is exercised;
- (b) companies that exercise control;
- (c) companies with which a consortium is formed;
- (d) other companies that are under the control of (a), (b) and (c) via the board of directors.

Section 185 ITC also contains a provision in subsection 2(b) on the basis of which Belgium will refrain from taxing the profits a Belgian company would not have realized if it had not been party to related-party dealings. In essence, the cost structure (or profit potential) of an enterprise that is a member of a multinational group is expected to differ from that of an independent enterprise. The benefit resulting from this difference does not stem from a different functionality and/or risk profile and should therefore not be allocated to the Belgian enterprise.³

Section 185 allows for unilateral adjustment of the Belgian tax base, similar to the corresponding adjustment under article 9(2) of the OECD model convention.⁴ The underlying assumption is that the “excess profit” forms part of the (arm’s length) profits of one or more foreign related parties.

In interpreting what is meant by the “part of profits of the foreign related party”, one should negotiate a unilateral APA with the Belgian service for upfront decisions in tax matters (APA Commission).

A parliamentary question⁵ has been raised as to whether section 185(2) can be married with the legality principle under the Belgian Constitution,⁶ as this would give prevalence to economic reality while being based on a treaty provision whose sub-article 1 had only a “model role” rather than being of binding force and whose sub-article 2 was not in the natural course of events included in Belgium’s bilateral treaties on the avoidance of double taxation. In his reply, the Minister of Finance emphasized that section 185(2) was based on “legal reality” rather than introducing a concept of “economic reality”. The Minister referred to §1.36 of the OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD guidelines), which says that “in other than

³ I. Verlinden and C. Costermans, “Belgium: Supply Chain Management”, *International Transfer Pricing Journal*, IBFD, vol. 13, no. 4, 2006, p. 173.

⁴ I. Verlinden and P. Boone, “Article 185 Paragraph 2 b: Creating opportunities in Belgium”, *Tax Management Transfer Pricing Report*, vol. 14, no. 9, 2004, p. 392.

⁵ V&A, Kamer 2003–4, no. 49 of 8 October 2004, p. 7451.

⁶ Art. 170.

exceptional cases, the tax administration should not disregard the actual transactions or substitute other transactions for them”.⁷

Section 185 ITC does not cover:

- domestic inter-company transactions;
- cross-border inter-company transactions between an enterprise and a physical person (acting in the course of a business) or between two physical persons acting in the course of a business;
- transactions between independent companies.

These latter transactions at all times fall under section 26 ITC,⁸ which has for years been the main reference for assessing whether the arm’s length principle is honoured.⁹ It provides authority for taxable profits of individual companies or enterprises in Belgium to be increased where the tax authorities can demonstrate that so-called “abnormal or gratuitous benefits” are granted to individuals or companies established in Belgium or abroad. It does not apply if the benefits are taken into account to determine the taxable income of the beneficiary.¹⁰ This “escape clause” will probably still apply to the afore-mentioned transactions that are not captured under section 185(2).

A number of other provisions complete the Belgian legal framework on transfer pricing. Section 54 ITC precludes from business relief interest, charges for patent licences, manufacturing processes and royalties, etc. paid to foreign beneficiaries who reside in a country where the payments remain untaxed or are subject to a considerably more favourable tax regime. The administrative commentaries on the ITC¹¹ state that this “presumption of sham” is refutable in the case of a prevailing business purpose.¹² A similar provision applies to non-opposable asset transfers under section 344(2).

Sections 79 and 207 ITC provide that abnormal or gratuitous benefits directly or indirectly received from related enterprises cannot be set off against (carried forward or current year’s) losses, nor can any participation exemption or investment deduction be applied to the revenues stemming from those benefits. These

⁷ In §1.37, it is said that only two such exceptional cases exist, i.e. “where the economic substance of a transaction differs from its form ... [and] where the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price”.

⁸ C. Rolfe, *International Transfer Pricing 2006*, PricewaterhouseCoopers, 2006, p. 234; P. Cauwenbergh, “Nieuwe regels inzake verrekenprijzen gewikt en gewogen”, *Fiscoloog Internationaal*, 31 October 2004, 251, p. 2.

⁹ Circ. no. Ci. RH. 421/569.019 specifies on p. 3 that s. 185(2) expressly introduces the arm’s length principle “where it was already previously deployed in the application of section 26 ITC”.

¹⁰ Based on a disputable interpretation of certain accounting principles, the Belgian tax authorities may try to circumvent this exception; see P. Minne, *Cahiers de droit fiscal international*, vol. 89b, *Group Taxation*, International Fiscal Association, 2004 Vienna Congress, p. 189. Also confirmed in an upfront decision (“ruling”) in the case of transfers at accounting value (no. Ci.D132/053 of 25 May 2000 – via www.fisconet.fgov.be).

¹¹ <http://www.fisconet.fgov.be>, see no. 54/28.

¹² I. Verlinden, P. Boone, C. Goemare and K. Smits, *Guide pratique pour assurer votre défense en matière de prix de transfert. Absence de documentation: perdant ou gagnant?*, *Etudes pratiques de droit fiscal*, Brussels, Kluwer, 2004, p. 43.

are probably one of the rare provisions that actually penalize the beneficiaries of artificial profit shifts rather than the grantors.¹³

There are no topic-specific rules on the statute of limitations. Reference is made to sections 353 and 358 ITC. A three-year period applies, which is extended to five years in the case of fraudulent intent.

1.2. Importance of intangibles in the transfer pricing taxation system

Belgium adheres to the OECD guidelines. An administrative circular¹⁴ of mid-1999 explicitly refers to the OECD guidelines and includes an attachment setting out the first five chapters of the guidelines. An administrative circular merely offers guidance to public servants. This means that if a circular contains a provision that conflicts with a legal statute the court will only take account of the statute.¹⁵

In the absence of particular legal or administrative rules on intangibles,¹⁶ this report is marked by extensive references to the OECD guidelines, (unilateral) APAs, relevant case law and recent experience, particularly in the framework of transfer pricing enquiries conducted by the Belgian tax authorities since late 2004. Some even argue in this context that selected taxpayers are “bombarded” with lengthy requests.¹⁷ An in-depth questionnaire has been developed, which also addresses intangibles, as will be further outlined below.

Transfer pricing in general has not yet reached maturity stage in Belgium. The matter is dealt with in a fairly casuistic way as tax authorities are only gradually improving their competences, predominantly based on setting up specialist teams.¹⁸ Belgium does not have hard and fast rules on how to determine a fair amount of royalties for intangibles. Moreover, the case law is limited and, specifically in the matter of intangibles, it looks as if a fairly “taxpayer-friendly” approach is taken, with recognition that the matter is extremely difficult to handle. As an illustration, royalty payments in execution of a (genuine) technical assistance agreement proved to be fairly easily accepted between a parent and its subsidiary with only a few, vague considerations on the business purpose.¹⁹ In a judgment of January 2004, the court recognized the importance and specific nature of intangible assets in general and access to knowhow in particular. The decision explicitly mentions the difficulties surrounding intangibles in order to

¹³ For further guidance see M. Dassel and P. Minne, *Droit Fiscal: Principes généraux et impôts sur les revenus*, Brussels, Bruylant, 2001, 5th edn, pp. 727–730.

¹⁴ Circ. no. AAF/98-003 dated 28 June 1999, <http://www.fisconet.fgov.be>.

¹⁵ K. Leus, *Pseudo-Wetgeving*, Titel II, *De Interpretatieve en de Verordenende Omzendbrief in het Belastingrecht met inbegrip van de Problematiek van de Tegenwettelijke Belastingcirculaires*, Antwerp-Apeldoorn, Maklu Publishers, 1992, pp. 285–340; CE, no. 107,845, 14 June 2002, <http://www.raadvst-consetat.be>.

¹⁶ Unless s. 185(2)(b) were to be classified as a particular provision relating to intangibles. Even then, the reporter notes that the valuation would still be governed by the OECD guidelines.

¹⁷ See D. Van Stappen, “Belgian audit group seeking detailed transfer pricing data”, *Tax Management Transfer Pricing Report*, BNA, 11 May 2005, vol. 14, no. 1, pp. 38–41.

¹⁸ Circ. no. Cp.221.4/A/601.321 (AOIF 26/2006) dated 4 July 2006.

¹⁹ S. Van Crombrugge, *De Juridische en Fiscale Eenheidsbehandeling van Vennootschaps-groepen*, Antwerp, Kluwer Rechtswetenschappen, 1984, pp. 433–434.

justify a verdict supporting the taxpayer's position in that case.²⁰ Already thirty years ago, legal writers evidenced that it was very difficult to estimate the value of intangible rights.²¹

Taxpayers are urged to properly document inter-company transactions so as to mitigate the risk of challenges by the tax authorities. An illustration can be found in a judgment of the Brussels Court of First Instance.²² A Belgian company was considered to have overpaid a Dutch affiliate because the Dutch company sold IT programs "all in". Additional invoices for compensating the value of the intangibles embedded in the software updates were not considered to reflect open-market conditions given the lack of any contractual obligation to pay the charge.

2. The definition of intangible property

2.1. The definition and classification of intangible property

There exists no specific definition of "intangible property" for transfer pricing purposes.²³ Intangible property is considered to be part of the intangible assets of a company, a concept for which one needs to rely on the definition as laid down in accounting law,²⁴ under which intangible fixed assets are categorized as follows:

- research and development expenses;
- concessions, patents, licences, knowhow, trademarks and other, similar rights, goodwill; or
- pre-payments for intangible assets.

The term "royalty" is not defined in Belgian tax law, either. References to royalties can nevertheless be found in section 17 ITC. The revenues below qualify as royalties for Belgian tax purposes:

- revenues from the rental, leasing or use of a concession over movable assets that are subject to withholding taxes; or
- revenues from copyright or similar rights that are identified as unearned income and subject to withholding taxes.

In Belgium, it looks as though, in both tax and accounting jargon, the terms "intangible assets" and "intangible property", or "intangibles" for short, are frequently interchanged, and appear in fact essentially to cover the same subject-matter. In this report the terms are also used interchangeably. However, they are

²⁰ Brussels, 7 January 2004; *Fiscooloog*, 929, 24 March 2004, 10 (Rôle no. 97-fr-033 via FiscalNet).

²¹ P. Jans, *Les transferts indirects de bénéfices entre sociétés interdépendantes*, Brussels, Bruylant, 1976, p. 189, §8.66, and p. 190, §8.70.

²² 22 October 2004 (Rôle no. 2001/13362/A via FiscalNet).

²³ A. Smits, "Het belang van intangibles als 'key value driver'", *Fiscaal Praktijkboek Directe Belastingen*, 1999–2000, Ced. Samsom Diegem, de Fiscale Hogeschool en EHSAL-FHS Seminars, pp. 301–302.

²⁴ For an in-depth analysis of the relationship between accounting law and tax law, see S. Huysman, *Fiscale Winst: Theorie en praktijk van het fiscale winstbegrip in België*, Biblio, Kalmthout, 1994, Chapter V, pp. 233–314.

to be distinguished from the more restrictive legal term “intellectual property rights”.²⁵

Even though Chapter 6 of the OECD guidelines is not attached to the Belgian 1999 circular, it appears that the Belgian tax authorities do rely on “the number of specific considerations with regard to intangibles” as highlighted in that chapter. A definition of the term “intangible” is also provided there. An illustration of the fact that the Belgian tax authorities rely on the OECD guidelines in this matter as well can be found in the afore-mentioned questionnaire on transfer pricing. The definition of “intangible property” as laid down in §6.2 of the OECD guidelines is decisive. The guidelines refer in §6.3 to “commercial intangibles”, which comprise marketing intangibles and trade intangibles. The guidelines acknowledge in §6.12 that it may be difficult to make a clear-cut distinction between income from the two categories. One may then speak of “hybrid intangibles”. This is the case with, say, Coca-Cola.²⁶ The trade intangible is the secret formula for the drink and the marketing intangible results from the maker’s major advertising campaigns, etc. The largest transfer pricing litigation case ever, *SmithKline Holding Inc. v. Commissioner*, on which settlement was reached on 11 September 2006,²⁷ serves as an even better illustration.²⁸

On the one hand, the 1999 circular²⁹ refers to “intangible elements that relate to production such as general technical know-how as well as patents and specific know-how”. On the other hand, it mentions “intangible elements that relate to marketing such as trademarks, company reputation, the distribution network, the possibility to offer services to customers such as after-sales services or training”. Capital-market access is mentioned as having both a production and a marketing angle.

The merit of the classification is that it facilitates the unbundling of the various elements that together represent an intangible. It also makes it easier to set up a comparability analysis strategy.

Finally, the reporter is unaware of a distinction being made in any prescriptive rules in Belgium between routine and non-routine intangibles. Practitioners should nevertheless exploit the opportunities offered by differentiating between the two in the context of valuation (pricing) so as to select the most appropriate transfer pricing method. For instance, a residual profit split analysis could be most appropriate in the case of non-routine intangibles.

²⁵ For a detailed clarification of the legal concept of “intellectual property rights”, see I. Verlinden, A. Smits and B. Lieben, *Mastering the IP Life Cycle: Towards a tax-efficient management of intellectual property rights*, PricewaterhouseCoopers, 2005, pp. 28–35.

²⁶ *Ibid.*, p. 43.

²⁷ See press communiqué “GSK settles transfer pricing tax dispute with IRS” at <http://www.gsk.com> under “media centre”.

²⁸ The question in this case was whether the “true value in the drugs sold (predominantly Zantac) is derived thanks to the GlaxoSmithKline Holding (Americas) Inc. (Glaxo US) marketing strategy or by the R&D department of GlaxoSmithKline Plc (Glaxo UK)”. In the IRS’s view, Glaxo UK underpaid Glaxo US for marketing services performed by it while Glaxo US overvalued the trademark product bought from Glaxo UK. The reporter is of the opinion that, if medicinal attributes are the key success factors, the marketing effort should at best qualify as a service.

²⁹ Circ. no. AAF/98-003 dated 28 June 1999, p. 26.

Given the relevance of the International Financial Reporting Standards (IFRS) in the Belgian context, it is also worthwhile to refer to International Accounting Standard (IAS) 38, which aims at prescribing the accounting treatment for intangible assets which are not yet dealt with by any other standard.³⁰ It deals with the recognition, measurement and disclosure of intangible assets. It defines an intangible asset as “an identifiable non-monetary asset without physical substance, controlled by the entity and held for use in the production or supply of goods or services, for rental to others, or for administration purposes”.

A key attribute of intangibles in Belgium appears to be the fact that the enterprise should be able to obtain future economic benefits, including the sale of products or services, cost savings or other benefits resulting from use of the asset by the entity. This probably makes sense from the viewpoint of the accounting prudence principle as benefits should exceed depreciation charges from the perspective of justifying capitalization. This argument holds true even though “claims for future benefits” (such as cost savings, increased revenues) that do not have a physical (e.g. a factory) or financial (e.g. a stock or a bond) embodiment are not laid down in the Belgian rules, unlike, say, in the USA. Moreover, the legal-protection criterion may in some instances be relevant in classifying intangibles. Nevertheless, marketing intangibles do not need such protection. They are “the product of a company’s market research or sales activities and they are generally applicable to more than one product that is offered by the company in question”.³¹ In the same way, knowhow is described as “all the undivulged technical information that is necessary for the industrial reproduction of a product or process”.³² It is not relevant whether or not this undivulged technical information qualifies for protection.³³

Intangible property can be transferred to another party. When the right is so transferred, the former owner will of course have no title to continue exercising any of its rights, unless it is given a licence to do so. A licence entails the holder of such intangible assets being able to grant a right to an identified third party to commercially exploit the assets.

Transactions concerning technical services are not necessarily governed by the same rules as transactions covering the sale or licensing of intangibles, even though they may give rise to controversy.³⁴

Tax authorities may be tempted to contend that knowledge and experience in the heads of these employees are to be regarded as intangibles. It should be noted that no royalty is appropriate in the context of a multinational group,³⁵ as, in arm’s length relationships between unrelated parties, a new manufacturing enterprise of this kind could recruit a plant manager from existing

³⁰ For more detailed comments, see Verlinden, Smits and Lieben, *op. cit.*, pp. 35–40.

³¹ *Ibid.*, p. 42.

³² OECD guidelines, §6.3.

³³ Commentary on the OECD model convention, art. 12(11).

³⁴ An interesting analysis such as on the distinction between payments for services rendered and payments for the supply of knowhow can be found in “Tax treaty characterization issues arising from e-commerce – Report to Working Party No. 1 of the OECD Committee on Fiscal Affairs” by the Technical Advisory Group on Treaty Characterization of Electronic Commerce Payments, 1 February 2001 (see particularly p. 8 and pp. 11–16).

³⁵ Rolfe, *op. cit.*, p. 9.

companies in the industry ... and in such a situation, the plant manager would be paid a wage determined by market conditions, and no royalty would be payable to any party.

2.2. Special problems concerning the definition of intangible property

Experience³⁶ shows that the Belgian tax authorities seek evidence to qualify profit drivers such as efficient corporate management as intangibles. Where a corporation is earning a higher than average rate of profit without there being empirical evidence available to explain it, the tax authorities might at least see this as a reason for increased scrutiny. Useful inspiration can be found in the notion of “corporate going-concern attributes” as set forth by US writers.³⁷ In the case of the common use of “organizational procedures or processes that are based on experience within the group”, it may be hard to determine an arm’s length transfer price given that it is highly unlikely that this type of knowledge would ever be transferred to third parties. Even were this knowledge already to have been transferred to a third party, it would probably be of no value to it unless the whole group were transferred. The IRS has always fiercely resisted the inclusion of a requirement of “commercial transferability” of an interest before deeming that there are intangibles in a transfer pricing context. Nor can any reference to this concept be found in the OECD guidelines. One interesting concept can be found in §7.13 of the OECD guidelines relating to services, where it is stipulated that an affiliate is supposed not “to receive an intra-group service when it obtains incidental benefits attributable solely to its being part of a larger concern” and is thus given the benefit of a free-ride effect from the group’s corporate going-concern attributes.

Another special topic is highlighted by a judgment from the Liège Court of First Instance.³⁸ The court ruled on a case where the tax authorities had reclassified royalties under a licence as directors’ remuneration. A director of a brewery had licensed an infrastructure decoration concept and commercialization methods to the company in exchange for a 5 per cent royalty on turnover for five years. Given the fact that it was impossible to legally protect such rights, the payments were deemed to be consideration for services rendered by the director outside the bounds of the daily management of the company.

³⁶ Predominantly in the framework of discussing taxpayers’ responses to the afore-mentioned transfer pricing questionnaire.

³⁷ J. Mogle, “Intercompany Transfer Pricing for Intangible Property”, *Tax Management Transfer Pricing – Special Report*, 21 May 1997, Report no. 25, vol. 6, no. 2, pp. 36–38.

³⁸ 23 December 2004; Rôle no. 03-5034-A (via FiscalNet); in a similar sense, the Mons Court of Appeals, in its decision of 31 March 2004, rejected royalty payments by a company for exploitation rights over clients (i.e. patients) to a doctor who had previously contributed his activities to the company. These exploitation rights belonged to the doctor in his capacity as a physical person and could not be assigned to a company. The payments were reclassified as income of an active partner (case BE 04/8 via www.fisconet.fgov.be). For an illustration of the classification issues surrounding royalties, see also Upfront Decision no. 300,364 of 27 August 2004.

3. The ownership of intangible property

3.1. Factors for determining the ownership of intangible property

A quite fundamental distinction has to be made between “legal” and “economic” ownership. The latter concept can particularly lead to controversy simply because Belgium adheres to the OECD guidelines, which might not comprehensively define the concept of “economic ownership”. The reporter is of the opinion that “economic ownership” shows a preponderance of attributes over the concept of “beneficial ownership”, a common law concept which is therefore of a lesser relevance in Belgium. The legal owner is the entity recognized in law as the owner of property even though he may in fact be a nominee or agent. The beneficial owner is the entity in law entitled to enjoy the fruits of ownership and may differ from the legal owner, usually by agreement. Economic ownership embodies a non-legal distinction, referring to the entity that has contributed financially to the ownership of the property and that bears the associated risks. It follows from this that bare legal title to intellectual property will not necessarily carry all or even much of the intangible value. A typical example would be registration in the hands of a local entity, which might be nothing more than a legal requirement in a jurisdiction: here, further consideration of economic (and beneficial) ownership would be imperative. At the end of the day, as transfer pricing deals with a fair matching of income and expenditure given the functionality and the risk profile of the parties involved, the relevance of these concepts for the transfer pricing practitioner in the reporter’s view lies simply in the fact that it should be possible to channel income and/or cost streams to the entity or entities that “merit” them (even if the legal owner is different) as it is they that made the bulk of the efforts to develop and/or maintain and/or enhance value, as the case may be.

In the case of (legally) unprotected intangibles, the issue is relatively straightforward. The company that bears the biggest share of the costs in developing the intangible is to be seen as the economic owner. The OECD guidelines state that “it must always be examined which company has developed the intangible and, consequently, has also borne the costs and risks”.³⁹

When dealing with legally protected intangibles (patents, trademarks, etc.), the ownership issue is somewhat more complicated, except in the case of independent development of an intangible.

In this case, one enterprise in the group takes on the task of developing the intangible in its own name. It bears all the costs and risks. This means that, if no intangible ultimately comes into being, the loss will be borne by that company.⁴⁰ The legal and economic owners are the same enterprise. The developed intangible can then be licensed to other members of the group, which pay the legal and economic owner a market-standard fee.

The situation of joint development calls for a distinction to be drawn.⁴¹ First, joint development can take place within a multinational company group. To

³⁹ OECD guidelines, §6.3, see Verlinden, Smits and Lieben, *op. cit.*, pp. 116–117.

⁴⁰ *Ibid.*, p. 118.

⁴¹ *Ibid.*, pp. 118–136.

determine which entities will be each of the legal and economic owners, the role played by each entity will be very important.

Two different forms exist for developing an intangible. First of all, the research and development is done on a contract basis, whereby one or more companies in the group carry out all research and development activities, for which they are paid so-called service fees by another company, called “the principal”. The principal in turn bears all the costs and risks with regard to the success or failure of the research work. If the research and development is successful and results in the creation of an intangible, then the principal holds all intellectual property rights over the research results or developments, and all income from the intangible will be due to it.⁴² So the economic owner is the entity that bears the R&D costs as well as the risk of failure. The Belgian tax authorities (including the APA Commission) are well acquainted with this concept. For instance, Belgian coordination centres⁴³ must not legally own intangibles. However, they are authorized to render contract R&D services, in the normal course of events under a cost plus arrangement. Other examples are the previously well-known safe harbour regimes for service centres, which have meanwhile been proscribed by the Belgian tax authorities under pressure from Europe in the context of potentially harmful tax schemes. Cost plus arrangements for contract R&D are easy to attain. Since January 2005, the APA Commission has demonstrated that it is actively engaged in issuing rulings that basically offer treatment similar to that which could be obtained under the service centre regime.⁴⁴

Please note that the development of marketing intangibles can also be governed by the same type of contract. However, although a contract can be used to develop intangibles, it is not the case that subsidiaries contribute to developing the parent company’s brand name in the country where they are established. A typical example would be where a parent company uses the services of a subsidiary to distribute merchandise produced by the parent in the subsidiary’s country of residence. The appeal of the product in consumers’ minds, i.e. the brand, can already be valuable in some sales territories but less so or not at all in others, so that the subsidiary may have to make significant marketing efforts to be successful in penetrating its local market. The question may then be whether the subsidiary needs to be compensated by the parent for the higher value that it confers on the already existing marketing intangible.⁴⁵ Unlike, say, in the USA, the Belgian tax authorities do not seem to take a particularly harsh stance in these circumstances but rather stick to the OECD guidelines. In the absence of case law on the topic, one could simply rely on the experience of tax audits, where it seems as if the tax authorities look at the amount of costs incurred by the subsidiary in coming to an assessment as to the “fairness” of these amounts in comparison to what independent distributors with similar functionality and risk profile would expend.

Cost sharing arrangements can also be used.

⁴² *Ibid.*, p. 120.

⁴³ Royal Decree no. 187 dated 30 December 1982.

⁴⁴ See below in section 6 for illustrations.

⁴⁵ Mogle, *op. cit.*, p. 13.

Second, joint development can take place outside the bounds of a multinational group. This happens for instance when there is collaboration with third-party contractors, corporate partnering, corporate venturing, and so on. It is probably too easy to simply argue that, in all of these scenarios, the conditions should automatically comply with the arm's length standard as these are third-party transactions. We feel that the answer to this question is less straightforward and that it should first be assessed whether there is a "controlled transaction", i.e. between associated enterprises and, if so, whether these transactions are engaged in while honouring the arm's length standard. The notion of "associated enterprises" is not much commented on by the OECD. The OECD guidelines do not contain a definition but rather refer to article 9(1)(a) and (b) of the OECD model tax convention. Under article 9(1)(a), a transfer pricing adjustment is allowed when a company in one treaty state participates in the share capital of a company located in the other treaty state (no minimum threshold is mentioned), to the extent that the business profits concerned are affected by (commercial) terms and conditions differing from those customary between enterprises acting independently from each other.⁴⁶ As we have said before, Belgium adheres to the OECD guidelines. However, it does adopt a broader notion of associated enterprises. Basically, any form of *de facto* or *de jure* control is sufficient, as generally accepted and applied before the courts.

3.2. Special problems concerning the ownership of intangible property

In general, Belgium offers fertile ground for litigation as the tax authorities and courts take legal ownership as a starting point and then analyse economic entitlement to the benefits. Illustrations can be found in the afore-mentioned questionnaire on transfer pricing. Moreover, the APA Commission also draws a distinction between legal and economic ownership. The Belgian case law also contains an interesting illustration where the tax authorities took the view that a Belgian company was artificially shifting profits to its French parent by paying royalties for use of the parent company's name whereas the Belgian subsidiary carried the same name (as laid down in its by-laws). It is to be noted that the taxpayer's position here was undermined by the fact that the tax authorities stated that the French shareholder had free disposal over the name by means of its dominant position and that the royalty arrangement was only set down on paper seven months after incorporation of the Belgian subsidiary. However, the reporter feels that the decision lacks reasoning based on pure transfer pricing principles. Even though the Belgian subsidiary's name coincided with that of its parent company, it should have been assessed what services were rendered by the French parent in developing, maintaining and enhancing the value of the name as a "brand" in consumers' minds.⁴⁷

⁴⁶ K. Vogel, *On Double Taxation Conventions*, Deventer, Kluwer, 1996, p. 517.

⁴⁷ Brussels Court of Appeals, 4 October 1972, *in causa Veritas*, JPDF, 1972, p. 311.

4. The transfer of intangible property

4.1. The determination of when an intangible is transferred to a related party

Tracing legal ownership is key prior to embarking on a functional analysis leading to insights on economic ownership. The legal owner may potentially have no valid claim to profit from a transfer pricing perspective beyond some notional profit where another party invests effort in terms of functions, expense and entrepreneurial risk to justify how exploiting the intangible is appealing from a profitability viewpoint.

One should first find out whether an intangible can be transferred as such. In principle, intellectual property rights can be licensed by the owner or right-holder, or transferred to a third party.⁴⁸ Conducting a thorough legal audit is nevertheless recommended to make sure the tax side does not risk conflicting with the legal ownership side such as in the case of a pre-emption right granted by the owner to the licensee. The audit will also reveal whether the intangible property right is actually held by the transferor/licensor and whether it still exists, is still enforceable and has not lapsed. Furthermore, in the particular case of a trademark, it needs to be investigated whether the laws under which the trademark has been granted require the owner also to transfer the business to which the trademark belongs.⁴⁹

Intellectual property laws tend to require a transfer of, or licence over, an intellectual property right to be set down in written documentary evidence (often governed by general principles of civil law). An agreement is not only advisable from a legal perspective, allowing the transferor to avoid controversy by making appropriate representations and warranties; it is equally relevant from a transfer pricing perspective as, at the end of the day, documentation is of paramount importance in this regard. There is Belgian case law in which the deductibility of royalty payments was rejected because no upfront agreement existed and the taxpayer therefore could not demonstrate that the amounts were contractually due.⁵⁰

From a tax perspective, relevant aspects when transferring intangibles are capital gains exemptions or at least a deferral of the taxes due on capital gains realized as a result of the divestment.

Three ways of selling an intangible can be distinguished:⁵¹

- (a) an asset deal. A capital gain may arise. As Belgium does not have special rules on the taxation of capital gains realized on intangible assets, the ordinary taxation regime applies;
- (b) a share deal. The outcome can be either a capital gain (which can be tax-exempt if the shares qualify for the Belgian participation exemption) or a capital loss (which is not deductible for Belgian tax purposes);

⁴⁸ For further reference to the transfer of legally protected rights, e.g. patents, see art. 28(2) of the TRIPS agreement.

⁴⁹ Art. 21 of the TRIPS agreement allows member states to include this obligation in their local laws.

⁵⁰ Van Crombrugge, *op. cit.*, p. 425.

⁵¹ *Ibid.*, pp. 305–306.

- (c) intellectual property may also be contributed as an asset to another company as part of a contribution in exchange for shares. Contributions of this type may give rise to a taxable capital gain, except for intellectual property which is part of a business or a universal transfer.

A particularly burdensome exercise may be recognizing transfers of intangibles in the case of the (deemed) deployment of intangible assets in the framework of business reorganizations, where intangibles risk being transferred “unnoticed”. The OECD is particularly interested in the domain of business reorganizations. A roundtable was organized with the business community in January 2005,⁵² alongside ongoing informal consultations with the business community. Working parties 1 and 6 are both involved.

“Conversions” or “migrations” have become common within multinational companies over the last decade, especially in centralized groups where arrangements may be altered, withdrawn, extended, limited or terminated almost overnight on the basis of the strategic, tactical and operational priorities of the group. The tax authorities will in these cases investigate whether the purported allocation of risk is consistent with the economic substance of the transactions, and the parties’ actual conduct will be taken as evidence of the true allocation of risk.⁵³

The Belgian tax authorities take a consistent stance in assessing such “streamlined” structures where, under such conversions, local Belgian entities are “stripped” of functions and risks and, consequently, also of profitability. The afore-mentioned transfer pricing questionnaire deals with the assessment of “phase-out” tax consequences upon conversion. The upside is that it is unlikely that future losses will arise, as the lack of entrepreneurial risk makes it more likely that such entities will realize a moderate but steady profit. Low cost plus compensation from manufacturers and moderate margins, or even cost plus compensation such as under a Berry ratio⁵⁴ approach, are equally likely to be accepted.

The tax authorities will verify whether the functionality and risk profile have effectively changed upon conversion; the reporter is of the opinion that they may also (validly) verify whether the “entrepreneur” or “principal” under the new structure actually has the capabilities to act as the “spider in the web” in the new structure and centrally “manage” and “oversee” the business. It may be tempting to e.g. simply state that capital should be the prevailing threshold for screening whether the purported allocation of risk is fair. Reference can be made to, say, hedge-fund managers, who execute functions without actually assuming risk. Some refinement of the analysis may be appropriate in the sense that the entrepreneur may need to be effectively capable and/or enabled to actually credibly control risk.

The reporter has submitted a background document to the OECD roundtable focusing on the tax implications of relocating production capacity.⁵⁵ The likelihood is remote that tax authorities might tax the shift of an intangible in the form

⁵² Second Centre for Tax Policy and Administration Roundtable, Paris, 26–27 January 2005.

⁵³ See paper by Mrs C. Silberztein, Head of Transfer Pricing OECD, previously posted at <http://webdomino1.oecd.org/COMNET/CTP/roundtable.nsf>; the paper can still be obtained by request directly from the OECD.

⁵⁴ Upfront Decision no. 500,084 dated 8 December 2005.

⁵⁵ For an in-depth analysis of the paper, see Verlinden, Smits and Lieben, *op. cit.*, pp. 235–243.

of a “sufficiently assured profit potential”, provided *inter alia* that a sufficient notice period was given to the “stripped” entities and no proprietary knowhow was migrated. It might be good to have all the requisite decisions taken and communications given by the relevant enterprises, and it may be particularly convincing if it can be demonstrated that buy-in from local management was obtained. In a centralized group, this would simply come down to validation by the local board, whereby the minutes should clearly outline the rationale for the decisions and their benefit to the entities concerned.

4.2. The problem of embedded intangibles or package deals

In the case of “embedded intangibles”, a transaction involving physical goods is effected between group companies and, without dwelling on the matter, an intangible is also transferred.

Belgium has no provisions that state that, in the case of embedded intangibles, there is no question of any transfer where the affiliated purchaser does not acquire rights to exploit the intangible, with the exception of the right of resale under normal commercial circumstances. Practice is not always clear cut, as distributors often undertake marketing activities regardless of whether they possess the relevant trade names or trademarks.

Take the case of a foreign manufacturer of branded products looking for a local footprint in Belgium (where no brand equity has yet been built up), where a Belgian subsidiary is made part of the distribution network and licenses the trademarks/trade names. If the Belgian entity makes sales efforts using its own funds in order to penetrate the local market, the question is very much whether rights have been built up by the Belgian entity in relation to the trademarks/trade names. It is to be assessed whether it is in accordance with open-market conditions that the Belgian subsidiary bears the market penetration cost in full. If so, it would be hardly defensible in this situation for royalties to be charged by the foreign company for use of the trademarks/trade names.

This would be in line with the OECD guidelines,⁵⁶ which extensively cover the distribution of brand-name products, whereby an associated distributor is involved in significant marketing activities but does not have any share in the ownership of the trademark or trade name associated with the product.

4.3. The aggregation of transactions and the roundtrip problem

A “roundtrip” situation occurs where (often) a parent company provides a subsidiary with intangible assets that are necessary to produce physical goods, which are subsequently sold back to the parent company. The reporter is unaware of Belgian rules or Belgian case law dealing with this matter, again contrary to what can be found in, say, a US context.⁵⁷ The Belgian tax authorities should, here too, have no reason to abandon adherence to the OECD guidelines. Consequently, one should not state *a priori* that the parent company has transferred intangibles to

⁵⁶ OECD guidelines, §6.36–6.39.

⁵⁷ Reference can be made to *Eli Lilly & Co. v. US, Sundstrand Corp. v. Comr., Bausch & Lomb Inc. v. Comr.* and *Compaq Computer Corp. v. Comr.*; a summary can be found in *Tax Management Transfer Pricing Report*, vol. 14, no. 21, p. 936.

the foreign subsidiary with the consequence that the foreign affiliate should be entitled to a considerable portion of the profit that is realized on the goods produced by it. A diligent functional analysis has to be done to assess whether similar transactions are likely to occur in an open-market context without there being any transfer of intangibles.

4.4. The problem of location savings

Location savings usually emerge when companies transfer production or operational sites from high-cost economies to economies with lower labour, land and raw material costs. Advantage is taken of price differences in, predominantly, the cost of labour, which is then weighed against increased costs in terms of logistics and quality control.⁵⁸ Once quantified (i.e. using a detailed comparison of each element of the location savings), the profits from location savings have to be attributed under application of the arm's length principle.⁵⁹ The reporter is of the opinion that it would be too easy to state that location savings should flow to the enterprise that has decided to relocate production capacity to a lower-cost jurisdiction. Indeed, in line with the very essence of the OECD guidelines, higher profits to the manufacturer would probably only be justifiable if the cost differences were to increase the profits of comparable uncontrolled manufacturers operating at arm's length, given the competitive positions of buyers and sellers in the market in the low-cost location.

The reporter is unaware of any Belgian case law on this topic, or of any Belgian APAs. Consequently, as the 1999 Belgian circular refers to the OECD guidelines, the "factors of comparability" as laid down in the guidelines should be taken as a basis, particularly where geographical differences are dealt with.⁶⁰ Given the priority allotted to the CUP method, it might be worthwhile seeking solid arguments to build up the case for allocating the location savings to the new (low-cost) manufacturing entity.⁶¹

4.5. The assignment of employees

The knowledge of key employees sent from their home base to manage a new facility can be extremely valuable. Nevertheless, the physical person *per se* cannot be seen as an intangible. Consequently, the value embedded in their labour contract can be substantial and other employers may envy the current employer for having that person on board. However, as "taking ownership" of an employee is legally impossible, as is forcing someone to commit to long-term or lifetime employment, in the reporter's view it is not possible to argue that an intangible is transferred.

⁵⁸ M. Ikeya and N. Mori, "Quantifying, Attributing Additional Profit from Location Savings", *Tax Management Transfer Pricing Report*, vol. 14, no. 21, p. 933.

⁵⁹ *Ibid.*, p. 394; D. Jimenez Moncada, "Location Savings: Who is Entitled to the Additional Profit?", *Tax Planning International Transfer Pricing*, June 2006, p. 6.

⁶⁰ OECD guidelines, §1.30.

⁶¹ In the absence of precedents in Belgian case law, inspiration may be sought in US case law, in particular in *Compaq Computer Corp. v. Comr.* T.C. Memo no. 1999-220, 7/2/99 (target years FY 1990-2).

4.6. The problem of the foreign governments' regulations

As the Belgian tax authorities consistently abide by the OECD guidelines, foreign government regulations containing safe harbour regimes that neither would nor do reflect the arm's length standard or foreign exchange regulations or commercial law considerations that would equally violate the OECD principles will not be taken into account.

5. Determining the arm's length price of intangible property

5.1. The transfer pricing methodologies for transactions involving intangibles

Several methods are available to determine the arm's length principle:

- (a) As Belgium follows the OECD guidelines, the CUP method should prevail. The 1999 circular mentions the need for typical comparability adjustments, e.g. when dealing with branded versus unbranded batteries. Unfortunately, no further practical guidance is provided.⁶² Given the large extent of typical, subjective, emotional elements that underlie e.g. brand appreciation in consumers' perception, quantifying such adjustments may be hard.⁶³ On the other hand, pursuing a full-blown CUP analysis may be of particular merit, especially in cases where, say, location savings have to be defended as flowing to the seller's jurisdiction. The fact that US case law shows a tendency towards increasing "sympathy" for the CUP method may act as a catalyst in a Belgian context.⁶⁴
- (b) The resale price method is highly uncommon and is probably only worthwhile considering when assets are sub-licensed to third parties.
- (c) The cost plus method is also fairly unusual unless there is a causal connection between cost and income.⁶⁵ Such a causal connection is quite difficult to determine.⁶⁶
- (d) The OECD lists a number of "other methods" that are advanced "when traditional transaction methods cannot be reliably applied alone or exceptionally cannot be applied at all".⁶⁷ The OECD guidelines do not exhaustively prescribe all the ways in which profit can be divided, so taxpayers may pos-

⁶² As a matter of fact, the example in the circular looks similar to what is said about athletic shoes that are differently branded under §6.25 in the OECD guidelines.

⁶³ For a critical assessment of the CUP method, see Verlinden, Smits and Lieben, *op. cit.*, pp. 71–79.

⁶⁴ References to US case law can be found in *ibid.*, pp. 76–79.

⁶⁵ For a critical assessment of the cost plus method, see *ibid.*, pp. 81–83.

⁶⁶ See M.G. Dekimpe and D.M. Hanssens, "Lange-termijn effecten van marketinguitgaven: onmeetbaar en dus onbestaand, of toch niet? Effectiviteitsmeting van marketinguitgaven: een historisch perspectief", *Business Inzicht: Een bericht over onderzoek aan het Departement Toegepaste Economische Wetenschappen van de Katholieke Universiteit Leuven*, 2001, no. 7, pp. 2–3.

⁶⁷ OECD guidelines, §3.1.

sibly opt to apply any other acceptable method.⁶⁸ In a Belgian context, in the absence of hard and fast rules, commentaries or case law, it may be worthwhile addressing some possible alternatives.

Under the residual profit method, a licence fee can be calculated by effecting a split of the profit of the licensee in such a manner as may be expected in the context of unassociated parties in a joint-venture relationship. At the basis lies a functional analysis of the licensee, whereby the functions, risks, deployed assets and available capital of the licensee are listed, as a function of which a fair income is allotted to the participating parties. The remaining result is divided between the licence fee for the owner and the profit that is generated by exploitation of the intangible asset. This split is necessary since no one would take out a licence for a fee that swallowed up the entire expected profit. Practically speaking, the total profit of a business or a basket of transactions can be split into two components: (a) the profit attributable to the “routine” functions of the parties involved (distribution, sales, marketing or manufacturing); and (b) the incremental, non-routine profit associated with the value of the intangibles. This approach comes down to a practical way of avoiding valuing the intangibles as such. What is valued is anything but the intangibles, leaving the remainder as their value. This method has particular merit for valuing a business as a whole or a combination of intangibles. Using it to determine the value of one specific intangible item within a bundle of intangibles is more cumbersome.⁶⁹ It is to be noted that this method is quite similar to discounted cash flow (DCF) models, where economists look at expected future profits or cash flows. Not only stock market and accountancy experts but also tax authorities tend to accept the DCF method.⁷⁰ The method has been successfully applied in valuing so-called “informal capital”.⁷¹

The transactional net margin method (TNMM) also avoids valuing the intangible as such. The “tested party” concept comes into play, meaning the participant in a related-party transaction from whose perspective the arm’s length nature of the dealings will be validated. The assumption is then that, if a transaction is at arm’s length from one end of the spectrum, it will also be so at the other.⁷² When valuing licence or royalty flows, one would thus select the licensee as the tested party and look at the net margins achieved by, say, a routine distributor who does not own valuable intangibles. The licence fee would then be set at a level to ensure that the licensee achieved an arm’s length routine profit, leaving the excess profit with the licensor. The outcome is similar to what is arrived at under the residual profit method. Similar drawbacks can be listed, i.e. if a basket of intangibles is at stake.

As to the use of databases to screen comparable data, it is noteworthy that the tax authorities and the APA Commission tend to show some reluctance in accepting the use of proprietary databases.

⁶⁸ *Ibid.*, §3.23.

⁶⁹ For an example of the application, see Verlinden, Smits and Lieben, *op. cit.*, pp. 83–84.

⁷⁰ Even though tax authorities usually refer to “operating profit” rather than “(free) cash flows”. The OECD guidelines only briefly address DCF under §3.22.

⁷¹ C. Mattelin, “Info-kap-rulings: werking en correctiemechanisme”, *AFT*, 2, February 2002, pp. 75–76.

⁷² A similar approach is taken in §3.43 of the OECD guidelines.

5.2. The commensurate-with-income standard

Belgium does not have a concept that requires the compensation for transfers of intangible property interests to be revalued on a periodic basis. In situations where the initial determination of royalty rates or other compensation was predicated on income projections that are manifestly inaccurate, periodic adjustments are possible, though only insofar as would also be realistically possible between third parties. To put it in the words of the OECD, “in determining the anticipated benefits, independent enterprises would take into account the extent to which subsequent developments are foreseeable and predictable”.⁷³ Parties may indeed find that projections are sufficiently reliable to fix the transfer pricing at the outset or provide adequate protection against the risk posed by the uncertainty in valuing the intangible. Such clauses are not uncommon. So-called “step royalties” may be worthwhile considering, as these also occur in an open-market context. The US APA practice may serve as a precedent.⁷⁴

For the sake of completeness, it is important to note that the 1999 circular rejects the use of hindsight, in line with the OECD guidelines. The circular explicitly refers to intangibles. Where the intangible has been developed recently it may be difficult to value the asset given the uncertainties surrounding future development. Even if it appears after some time that the value is substantial, it is not necessary to adjust the transfer price automatically. Provided the analysis at the time of the transaction was supported by contemporaneous evidential documentation, no elements need to be taken into consideration that might show a higher value at a later point in time.⁷⁵ The Antwerp Court of First Instance ruled in 2003 in a case involving the share valuation of an insurance company where the intrinsic value greatly exceeded the value based on economic return. Use of the latter was not considered by the court to constitute reliance on hindsight.⁷⁶

6. Advance pricing agreements (APAs)

Belgium has a history of informal agreements with the tax authorities. The concept of unilateral “upfront decisions”,⁷⁷ which include APAs in the sense of the OECD’s interpretation, has existed since 1993. Both the procedural rules and the practice were revisited in 1999, 2002 and again in 2005.⁷⁸ Bilateral and multilateral APAs are governed by the relevant double taxation treaties.⁷⁹ Bi- or multilat-

⁷³ OECD guidelines, 6.29.

⁷⁴ “Practitioners applaud IRS flexibility, analyze findings in second APA Report”, *Tax Management Transfer Pricing Report*, 2001, vol. 9, no. 24, pp. 903–905.

⁷⁵ Circ. no. AAF/98-003 dated 28 June 1999, p. 31.

⁷⁶ 4 June 2003; *FJF*, 2004/130; decision A1 03/14 (via www.fisconet.fgov.be).

⁷⁷ Initially called “upfront agreements”.

⁷⁸ S. 345 ITC, Royal Decree of 3 May 1999, Act of 24 December 2002; for a comprehensive overview of upfront decisions in summary format, see www.fisconet.fgov.be or www.ruling.be.

⁷⁹ For a historical overview, practical hints and theoretical aspects, see R. Willems, *De Belgische Rulingpraktijk*, Fiscale Praktijkstudies, no. 30, Kluwer, 2005, 180 pp.

eral APAs are also processed by the same office as unilateral ones, i.e. the service for upfront decisions (APA Commission).

APA practice is well known in Belgium and taxpayers easily find their way to the APA Commission, especially since the time at which the last revision came into play, on 1 January 2005.

Experience in relation to transfer pricing and intangibles remains limited, however. Listed below are some potentially relevant topics addressed by the APA Commission.

6.1. Choice of methodology

After the first ever multilateral APA was signed by France, Germany, the UK and Spain (for Airbus), a further multilateral agreement was concluded in which Belgium also participated this time, alongside the Netherlands and France (for a European financial services corporation). The corporation sought agreement on its application of the profit split method.⁸⁰ There are also unilateral APAs in which a profit split has been accepted.⁸¹ This seems to indicate that economic integration and interdependence are seen as relevant factors for concluding that traditional transactional methods are not necessarily the most appropriate. However, the merits of the CUP are checked in the natural course of events⁸² and upheld where possible⁸³ or rejected if not sufficiently robust.⁸⁴ In one case on compensation in the framework of a licence agreement for distribution activities, no APA was granted given the lack of substantiation of the (cost plus) methodology.⁸⁵

6.2. Screening the absence of relevant intangible assets

Contract R&D providers are carefully screened as to functionality and risk profile so as to result in a cost plus compensation system (or a TNMM with cost as profit level indicator).⁸⁶ For a low-risk distributor/provider of marketing services, a Berry ratio has been accepted.⁸⁷ For a mere “administrative commissionaire” a

⁸⁰ “First Two Multilateral European APAs Signed; Airbus, Financial Firm, Six Nations Involved”, *Tax Management Transfer Pricing Report*, vol. 12, no. 23, 14 April 2004, p. 1113; “France’s APA Chief Sees Program Reaching ‘Cruising Speed’ (Interview with Mr P. Baudier, Head of France’s Direction Générale des Impôts’ International Affairs Unit CF3)”, *Tax Management Transfer Pricing Report*, vol. 13, no. 2, 26 May 2004, pp. 66–69.

⁸¹ See e.g. decision no. 300,338 dated 4 February 2004 (sector unknown) and decision no. 500,129 dated 26 January 2006 (for a retail activity) (both via www.fisconet.fgov.be).

⁸² See e.g. decisions nos. 500,163 dated 27 June 2005, and 500,300 dated 16 February 2006, where the cost plus was applied to support services (www.fisconet.fgov.be).

⁸³ Decision no. 500,207 of 15 December 2005, and decision no. 600,046 dated 9 March 2003 (both on interest, both via www.fisconet.fgov.be).

⁸⁴ Decision no. 400,011 dated 25 November 2004 (www.fisconet.fgov.be).

⁸⁵ Decision no. Ci.D 134/057 dated 15 September 2000 (www.fisconet.fgov.be).

⁸⁶ Decision no. 400,146 dated 15 February 2005 (cost plus 5 per cent); decision no. 500,229 dated 1 December 2005 (TNMM with cost as PLI – 6 per cent); decision no. 600,066 dated 6 June 2006 (cost plus 4 per cent) (all via www.fisconet.fgov.be).

⁸⁷ Decision no. 500,084 dated 8 December 2005 (www.fisconet.fgov.be).

cost plus (5 per cent) has been accepted.⁸⁸ Screening is also done for support services of an intellectual nature.⁸⁹

6.3. Recognition of economic ownership

In a case where partly capitalized development projects were centralized within a Belgian company with no physical resources, the taxpayer supported its application by referring *inter alia* to the fact that the company was the legal owner of the investments even though it could not be considered as the economic owner; it sought agreement on the on-charging (without a mark-up) of development costs incurred (either as such or in proportion to depreciation charges in the case of capitalized intangibles).⁹⁰ The APA Commission appears to have agreed with the allocation of routine profits (calculated as a mark-up of operating expenses and a compensation for pre-financing) to the legal owner of the software intangibles and premium profit to the economic owners in a case where development of the intangible was carried out by an operational affiliate on behalf of the legal owner. Legal ownership was held by a special purpose vehicle that incurred the development cost, even though the eventual bearers of the development and maintenance cost were the operational entities that actually used the intangibles.⁹¹

6.4. Valuation of goodwill

It is necessary to substantiate the proposed value extensively while taking account of the accounting rules.⁹² In a case where a medical business was contributed to a company, the goodwill calculated according to a mere rule of thumb (1.5 times the weighted average of turnover for the last four years) was not felt to be sufficiently justified.⁹³ A DCF-based methodology was accepted where (loss-making) production activities were relocated to a foreign country and seven-year straight-line depreciation was accepted on the goodwill expressed upon conversion.⁹⁴

It appears that the Ruling Commission welcomes the idea of having valuations supported by reports prepared by independent experts.⁹⁵

6.5. Business reorganizations

In a case where a fully fledged Belgian manufacturing entity and a full-risk buy–sell entity were respectively converted into a toll manufacturer and a com-

⁸⁸ Decision no. 500,235 dated 15 December 2005 (www.fisconet.fgov.be).

⁸⁹ See e.g. decision no. 500,023 dated 31 March 2005, and decision no. 500,074 dated 17 November 2005 (both via www.fisconet.fgov.be).

⁹⁰ Decision no. 500,271 dated 9 February 2006 (www.fisconet.fgov.be).

⁹¹ Unreported – see D. Van Stappen *et al.*, “Rulings recognize economic and legal ownership of intangibles”, *International Tax Review*, June 2006 (via www.internationaltaxreview.com).

⁹² Decision no. Ci.D132/077 dated 16 November 2000 (www.fisconet.fgov.be).

⁹³ Decision no. 300,244 dated 19 February 2004 (www.fisconet.fgov.be).

⁹⁴ Decision no. 400,295 dated 9 June 2005 (www.fisconet.fgov.be).

⁹⁵ Decision no. 400,184 dated 13 October 2005 (www.fisconet.fgov.be).

missionaire of a Swiss principal, there were held to be no phase-out costs in a sense of capital gains (i.e. goodwill).⁹⁶ In a similar case, at least with respect to the “stripping” of fully fledged activities into toll manufacturing and stripped buy–sell entities, the APA Commission was of the opinion that no goodwill (“conversion charge” in that case) required to be taken into account as *inter alia* no transfer of intellectual property rights occurred. However, given the fact that a number of licence agreements were terminated to the detriment of the Belgian entities, the APA Commission ruled that, over the five-year term of the APA, an undisclosed correction of the tax base was imperative as an indemnity payment.

In a case where a Belgian company that acted as a limited-risk distributor was converted into an agent, also in the framework of a pan-European reorganization, there was held to be no phase-out cost (i.e. goodwill). The expectation of the financial neutrality of the operation, i.e. that profitability after the conversion would be comparable to the return beforehand, was felt to be an important criterion. The fact that similar transactions had occurred with third parties without any indemnity being due was also held to be a decisive element.⁹⁷

7. Resolution under the mutual agreement procedure and arbitration

The reporter is unaware of any relevant mutual agreement cases in the public domain. It is consequently hard to see an upside in using mutual agreements over litigation. As said in the previous section, the reporter is aware of one multilateral APA (i.e. technically these are several bilateral APAs) in which Belgium has been involved. There is no information on any dissenting opinions encountered or controversy surrounding the definition of intangibles, ownership, time of transfer or methodology. The reporter is unaware of any closed cases involving Belgium where the Arbitration Convention was invoked.

⁹⁶ Decisions nos. Ci.D132/001 and Ci.D132/002 dated 13 December 1999 (www.fisconet.fgov.be); see T. Vanwelkenhuyzen and R. Willems, “First Transfer Pricing Rulings Issued by New Advance Ruling Office”, *International Transfer Pricing Journal*, July/August 2000, pp. 114–116.

⁹⁷ Decision no. 600,085 dated 13 April 2006 (www.fisconet.fgov.be).