NEW TRANSFER PRICING PROPOSAL FROM THE EUROPEAN COMMISSION

The proposal aims to incorporate the OECD transfer pricing framework into EU law and harmonize the transfer pricing standards within the Union.

INTRODUCTION OF THE NEW PROPSAL

Transfer pricing is a mechanism to determine the pricing of transactions between companies that are part of the same group.

This new transfer pricing proposal from the European Commission envisages to integrate the key transfer pricing principles as developed by the OECD into EU law, with the aim of putting forward certain common approaches for Member States. The proposal is a part of the broader EU initiative known as "Business in Europe: Framework for Income Taxation" (***hereinafter* BEFIT**).

THE CURRENT INTERNATIONAL STANDARDS

Currently, transfer pricing regulations are not completely harmonized in the Member States. For example, 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 respective national law. In fact, it is generally understood that article 9 is not "self-executing" as to domestic application. This was also recently mentioned in cases from the Court of Justice of the EU, where it was stated that without harmonization, any codification of the methods and criteria for determining an 'arm's length' outcome falls within the discretion of the Member States.[1]

Even when all Member States have domestic legislation in place that provides for a degree of a common approach by following the arm's length principle, the definition of associated enterprises and the notion of control, which are pre-conditions to apply transfer pricing, can differ among Member States. For example, certain Member States apply a threshold of a 25% shareholding while others apply a threshold of a 50% shareholding when it comes to determining whether the control criterion is met.

These different applications of transfer pricing rules among Member States causes a number of other problems, such as:

- ***Profit shifting and tax avoidance**, as transfer prices can be easily manipulated to shift profit and be used in the context of aggressive tax planning schemes.*
- ***Litigation and double-taxation**, as transfer pricing is more subjective than other areas of taxation and, for this reason, is sensitive to disputes, with tax administrations not always sharing a common interpretation.*
- ***High compliance costs**, resulting from businesses having to determine what prices could be regarded as arm's length, conducting studies, as well as compiling, maintaining and updating the related documentation.*

THE PROPOSAL

The Commission's proposal aims at harmonizing transfer pricing rules within the EU and ensuring a common approach to transfer pricing problems. The Directive lays down rules to ensure a common application of the arm's length principle across the Union with the aim of increasing tax certainty and reducing occurrences of double taxation as well as double non taxation.

Furthermore, the proposal clarifies the role and status of the OECD Transfer Pricing Guidelines and creates the possibility to

[1] Judgment of 8 November 2022, Fiat Chrysler Finance Europe v Commission (C-885/19 P and C-898/19 P), Judgement of 8 June 2023, European Commission v Grand Duchy of Luxembourg, Amazon.com, Inc., Amazon EU Sàrl (Case C-457/21 P).

establish common binding rules on specific aspects of the rules within the Union.

For example, in order to lower the compliance burden for taxpayers that operate cross-border within the Union, the commission proposes to introduce a common approach towards the documentation on transfer pricing. A standard documentation template, rules on content and linguistic arrangements, timeframes and which taxpayers should be in scope would bring simplicity and potential cost savings.

It is proposed that the Member States should implement the transfer pricing rules by 1 January 2026.

TAKE AWAYS

The proposal is a welcoming step into harmonizing key transfer pricing principles among the Member States. The proposal will increase tax certainty, potentially lower the administrative burden for taxpayers, and mitigate the risk of litigation and double taxation. Moreover, it will reduce the opportunities for companies to use transfer pricing for aggressive tax planning purposes.

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