

## Consultation response

# Transfer Pricing Directive



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## Executive Summary

The European Commission's Transfer Pricing (TP) Directive proposal aims to enshrine the arm's length principle (ALP) in EU law. Lawmakers should prioritise proper Pillar 2 implementation, and finalising international transfer pricing negotiations before legislating the ALP. We support the uniform application of the ALP across the EU and encourage lawmakers to develop mechanisms to support the consistent and coherent application of the ALP and OECD Transfer Pricing Guidelines if the Directive is not agreed on as drafted. The Proposal should also not restrict tax authorities' flexibility in negotiating with third countries. We encourage the Commission to establish of a forum for developing practical solutions to transfer pricing problems, and to encourage the availability of Advance Pricing Agreements in member states.

## Introduction

The Transfer Pricing (TP) Directive proposal, released by the European Commission on 12 September 2023 as part of the larger Business in Europe: Framework for Income Taxation Package (BEFIT Package), seeks to enshrine the arm's length principle (ALP) in EU law.

We encourage the Commission and Council to prioritise ensuring a successful implementation of Pillar 2 and to finalise international transfer pricing negotiations (e.g. Amount B of Pillar 1) prior to legislating the ALP.

We support the uniform application of the ALP across the EU. It is vital that the TP Directive promotes, encapsulates and does not depart from this standard. If it is not possible for member states to agree on the Directive as drafted, appropriate mechanisms to support member states' consistent and coherent application of the ALP and OECD Transfer Pricing guidelines should be developed.

In order to promote tax certainty and avoid double taxation, we would urge the Commission to establish a forum in which the Commission, member states and taxpayers can discuss and identify practical solutions to transfer pricing problems experienced. The EU Joint Transfer Pricing Forum served a similar role previously. In addition, member states should be encouraged to expand their availability of, and access to, Advance Pricing Agreements (APA) and ensure tax authorities are appropriately resourced to manage such taxpayer requests.

As it currently stands, the proposal to enshrine in EU law the ALP could lead to double taxation and increased tax uncertainty as it would restrict tax authorities' flexibility to negotiate, particularly with third countries.

## General comments

### *Alignment with OECD Principles*

Any proposal to legislate the ALP should fully align with the OECD Transfer Pricing Guidelines. In that regard, the TP Directive Proposal has a number of departures from the Guidelines. For example, the Directive (article 12 [4]) requires that if the results of a controlled transaction falls outside of the arms-

length range, an adjustment is made to the median – a requirement that differs from the OECD Guidelines. In addition, the proposal of the 25% ownership threshold for associated enterprises (expanded upon below) is stricter than the threshold of many member states.

Further, it needs to be clarified how amendments to the OECD guidelines which will occur over time will be adopted into EU law.

## Article-by-article comments

### *Recital 2 and article 3(1) – Open market forces*

The European Commission should clarify the meaning of ‘open market forces’ as the concept is not included in the OECD guidelines. Lack of clarification would likely lead to differing interpretations and application by member states. The Commission should also provide clarification on how the ALP is accommodated in the ‘open market forces’ concept. In addition, clarification on how the concept interacts with recent court decisions regarding State aid is required.

### *Article 5 – Ownership Thresholds for Associated Enterprises*

The proposed 25% ownership threshold for associated enterprises is too strict, departing from Pillar 2 rules and even from the thresholds used in most member states. The Transfer Pricing Directive should align with the Pillar 2 threshold.

### *Article 5(7) – Permanent Establishments as Associated Enterprises*

Noting that permanent establishments (PE) are defined as associated enterprises, it is unclear how to allocate profits to a PE and whether the OECD 2022 guidelines or the 2010 Authorised OECD Approach should be used. Similarly, it is unclear how to deal with agency PEs.

### *Article 7 – Compensating Adjustments*

To ensure coherence across taxes and levies, compensating adjustments required for transfer pricing should also be reflected for VAT and customs duties purposes

### *Article 12 – Interquartile Range*

Article 12(4) departs from the OECD Transfer Pricing Guidelines by requiring adjustment to the median of the interquartile range in cases in which the results of a controlled transaction falls outside of the arms-length range. The OECD Guidelines, on the other hand, permit adjustment to anywhere within the interquartile range. This misalignment could limit tax authorities’ room to negotiate with third countries and has the potential to create double taxation.

## Recommendations

We would recommend that further thought is given to enhance existing mechanisms for promoting tax certainty and avoiding double taxation related to transfer pricing in the EU.

*Improve access to Advance Pricing Agreements (APAs)*

The Commission should prioritise improving the accessibility of APAs across Member States. These agreements are vital to increasing tax certainty and to enhancing the attractiveness of Europe as an investment location. Tax authorities should provide adequate staffing and resources to APA teams to reduce the lead time associated with negotiating APAs. Once APAs are more available and accessible across member states, the European Commission could look into ways to foment cross-border cooperation.

*Expanding taxpayer access to EU-wide transfer pricing initiatives and forums*

Expanding the scope of the European Trust and Cooperation Approach (ETACA) initiative and reintroducing a forum similar to the EU Joint Transfer Pricing Forum (JTPF) would provide taxpayers with means of gaining certainty on transfer pricing activities.

The ETACA's scope should be expanded to include non-EU headquartered companies subject to Country by Country Reporting (CbCR). Likewise, its scope should be expanded to cover more complex transactions. Including non-EU headquartered multinational enterprises in the ETACA would make a significant contribution to tax certainty in the EU for foreign and domestic companies alike.

Similarly, the JPTF was a valuable resource for taxpayers when it was focused on resolving technical concerns raised by taxpayers. A forum similar to the EU JTPF should be reinstated in a targeted manner focused on resolving practical transfer pricing issues experienced by taxpayers.