Austria publishes new draft Transfer Pricing Guidelines for consultation

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In brief

Ten years after first publication of the Austrian Transfer Pricing Guidelines, the Austrian Federal Ministry of Finance issued its long-awaited update of the Austrian Transfer Pricing Guidelines for consultation (draft TPG 2020). An extensive revision of the 2010 guidelines (TPG 2010), the draft TPG 2020 aims to reflect in the latest jurisprudence and administration practice in Austria, including recent developments related to the Base Erosion and Profit Shifting (BEPS) project from the Organisation for Economic Co-operation and Development (OECD) OECD/G20 Inclusive Framework. Extensive comments were provided by businesses and practitioners to the 250-page document in early January. The final guidelines may be published before the end of the first quarter 2021 and will be effective upon publication.

The new administrative guidelines will be binding on the tax authority in their approach to assessing the arm’s-length nature of intercompany transactions. The draft TPG 2020 articulates that a dynamic interpretation is to be followed with respect to the OECD Guidelines. Therefore, multinational enterprises (MNEs) can expect that past periods under tax audit will be reviewed in light of subsequently issued OECD guidance and their interpretation in TPG 2020.

In detail

The draft TPG 2020 reflects the 2017 revision of the OECD Transfer Pricing Guidelines (OECD TPG) and its amendments, especially the Revised Guidelines on the Application of Profit Split Methods from 2018 and Transfer Pricing Guidance on Financial Transactions issued in February 2020, which became Chapter X of the OECD TPG. In addition to providing interpretation of the arm’s-length principle and practical guidance for consistent application of the OECD TPG, TPG 2020 also provides guidance on permanent establishment (PE) with updated content. Compared to the TPG 2010, references to court cases and to case-relevant guidance issued by the Ministry of Finance in the form of so-called “Express Answer Services” also have been extended to include new developments.

Observation: The draft TPG 2020 is substantially in line with the OECD TPG, incorporating even the latest update on Financial Transactions. The re-writing of sections from the 2010 guidelines in line with the consensus position iterated by the OECD is a welcome development. At the same time, the draft TPG 2020 differs in emphasis or interpretation in a number of important areas, which may lead to tax audit disputes for MNEs operating in Austria.

Legal basis

The OECD TPG is acknowledged as an instrument to aid the interpretation of Double Tax Treaties; the OECD TPG are to be used in their latest applicable version when interpreting the arm's-length principle. Only in cases where new guidance expressly deviates from earlier statements in the OECD TPG and cannot be seen as clarifying or supplementary guidance, can the version of the OECD TPG in place when the parties entered into the transaction in question be used. The draft TPG 2020 in principle is meant to reflect the latest OECD TPG and to be read in this sense.

Observation: Some intercompany arrangements now may become subject to tax audit scrutiny in Austria based on recent detailed guidance from the OECD that was not available at the time the transactions were entered into.

Intercompany agreements

The draft TPG 2020 sets a high standard with regard to recognition of intercompany agreements. These are to be recognized only if they are properly formulated, have a clear and unambiguous content, and would have been concluded under the same terms and conditions between independent parties.

Observation: In order to avoid potential nonrecognition of intercompany transaction terms, intercompany agreements must expressly and clearly address — among other terms and conditions unrelated parties would enter into — all transfer pricing relevant terms. This requirement may limit flexibility in their application over time and mean that intercompany contractual terms must be kept up to date with business practice and developments.

Transfer pricing methods

The draft TPG 2020 generally follows Chapter II of the OECD TPG when addressing the transfer pricing methods that can be applied to assess the arm's-length nature of intercompany transactions. Further, the draft TPG 2020 reflects the principles outlined in the 2018 Revised Guidance on the Application of the Transactional Profit Split Method. In addition, reference is made to the Profit-Split-Report issued by EU-JTPG (2019) as shall providing aid for interpretation in this area.

Observation: The draft guidance requires that, when applying the Transactional Net Margin Method (TNMM), no pass-through expenses are included in the cost base. This may create substantial practical difficulties when performing economic analyses since external comparable data rarely include sufficient granularity for a similar elimination of 'flow-through' items.

Arm's-length results

TPG 2010 introduced guidance on tax audit adjustments, stating that prices that fall outside the arm's-length range generally must be adjusted to the median. The relevant sections are adopted unchanged by the draft TPG 2020.

Observation: Typically, the 'arm's length range' has been interpreted as the interquartile range, and tax auditors tend to show little flexibility in considering less restrictive limitations to — e.g., to the inter-decile range or to using the full range. Routine entities (such as intercompany service providers, limited risk distributors, or contract manufacturers) operating in Austria should continue to monitor the development of profits to avoid actual results falling outside the interquartile range.

Year-end adjustments

Year-end transfer pricing adjustments are recognized only if four criteria are cumulatively met: (1) the ex-ante price setting is subject to significant uncertainty; (2) all efforts have been made during the year to achieve arm's-length prices (continuous monitoring); (3) factors that might influence the price setting were agreed in advance; and (4) the adjustment moves the results from a point outside the arm's-length range to a point within this range. In case of disagreement with the other state over the tax treatment of the transfer pricing year-end adjustment, taxpayers could initiate a mutual agreement procedure (MAP) under the applicable income tax treaty.

Observation: Based on the understanding that all points within the interquartile range are at arm's length, Austrian tax audit practice has routinely disallowed year-end transfer pricing adjustment that moved the taxpayer's results from a point within the interquartile range of benchmarked results into a particular target in the range. This created problems for some MNEs that steer the results of routine entities toward a consistent outcome taking advantage of year-end adjustments. The draft TPG 2020 explicitly endorses this practice and introduces further strict formal requirements with respect to year-end adjustments. MNEs can expect that targeting a specific outcome for routine entities only via year-end adjustments no longer will be possible in Austria.

Cost contribution arrangements

In line with the update of Chapter VIII of the OECD TPG, the draft TPG 2020 introduces stricter requirements with regard to the formation of, and participation in, cost contribution arrangements (CCA) by associated enterprises. The determination of arm's-length remuneration in the context of CCA also was revised, limiting the possibility to charge costs without a mark-up to activities when the arm's-length value is not materially different from the cost incurred.

Low-value-adding and routine intra-group services

The concept of low-value-adding services and the related simplified documentation rules in line with the OECD TPG are introduced in the draft TPG 2020.

With regard to "routine" intercompany services, the previous guidance that such entities' remuneration generally can be found in the range of 5% to 15% has been revised to a lower range of 3% to 10%, based on the Joint Transfer Pricing Forum's 2010 report, Guidelines on Low Value Adding Intra-Group Services. ***Note:*** Research and development (R&D) services are considered "high-value-adding" intercompany services that "generally cannot be remunerated by a mere 5% margin."

Financial transactions

Previous guidance on intercompany financial transactions has been completely revised largely in line with the 2020 OECD Report on Financial Transactions. Substantial emphasis is placed on the concept of delineation of the intercompany financing transactions based on a two-sided analysis of the lender and the borrower, considering both of their options realistically available. Guidance on the credit rating analysis (including the need to consider the impact of group association) also has been introduced, together with specific guidance on the arm's-length pricing of intercompany loans, cash-pooling, guarantees, and (captive) insurance.

Observation: The inclusion of detailed guidance on intercompany financing transactions is a major step in Austria as this increasingly has been a tax audit focus area, in particular cash pooling and intercompany lending and borrowing. The new requirements mean that intercompany financial transactions will need to be documented carefully and that market developments may have to be monitored continually in case of longer-term arrangements. While the guidance is substantially in line with that of the OECD, there are a number of differences in emphasis and formulation compared to Chapter X, which may lead to tax audit disputes in the future. For instance, based on the wording of the draft TPG 2020, Austrian tax authorities in the future may seek to recharacterize intercompany debt to equity due to missing formal elements of intercompany contracts or in cases where the borrower is in economic difficulties despite the fact that they could have received external financing in comparable situations.

Intangible assets

With respect to intangible assets, the draft TPG 2020 follows the updated Chapter VI of the OECD TPG, introducing the Development, Enhancement, Maintenance, Protection, and Exploitation (DEMPE) concept and the six-step analysis of intangibles-related transactions for the first time in Austrian administrative practice. The guidance relating to the valuation of intangible assets — including the consequences of transferring hard-to-value intangible assets — is in line with the OECD TPG. The draft guidance foresees that intangible-related profits may have to be allocated to "routine" entities (R&D service providers or local distributors) based on the analysis of DEMPE functions and related risks. Compared to the TPD 2010, the strict limitation language on the charging of license fees to distribution entities has been revised, allowing the charging of license fees in some cases even to routine distributors.

Group restructurings

The revision of statements in the section dealing with business restructurings has only clarifying significance compared to the TPG 2010, which substantially followed Chapter IX of the OECD TPG. In general, compensation for the restructuring may be required if something of value has been transferred or contracts have been terminated or substantially renegotiated, provided in all cases that compensation would be due between independent parties under similar circumstances.

Group synergies and location savings

With respect to group synergies and location savings due to the market-specific characteristics, the draft TPG 2020 is in line with the guidance in the OECD TPG. Location savings are to be allocated in accordance with principles outlined in Chapter I of the OECD TPG. ***Note:*** The draft TPG 2020 specifically refers to the treatment of the Austrian R&D subsidies ("Forschungsprämie") as an example of location benefits. The cost saving represented by these subsidies received by Austrian R&D service providers cannot automatically be allocated to the principal but may have to be shared with the service provider in line with the arm's-length principle considering also the parties' relative negotiating positions.

Permanent establishments (PE) profit allocation

The concept of "AOA light" is introduced by the draft TPG 2020 with respect to the profit attribution in PEs. According to this concept, the principles of profit allocation between a parent company and PEs outlined in the Authorized OECD Approach (AOA) are applicable in Austria only to the extent the updated version of Article 7 of the OECD Model Treaty has been adopted. The "AOA light" applies in case the updated version of Article 7 of the OECD Model Treaty has not been adopted. The key difference from the full applicability of the AOA is that interest and licensing fee charges are not recognized for tax purposes between a parent company and a PE, and costs related to services provided outside the group's core business activities must be recharged without a markup.

Observation: Since the AOA was fully implemented by some countries, it is possible that Austria's tax treaty partner country interprets the profit determination differently from the limited interpretation applied by Austria. In this case, the draft TPG 2020 refers to the possibility of resolving the taxation conflict within the framework of a MAP.

Documentation

The Austrian Transfer Pricing Documentation Law requires that only entities above the applicable materiality thresholds must prepare transfer pricing documentation following the Local File, Master File, and Country-by-Country Report structure introduced by the 2017 update of Chapter V of the OECD TPG. Until recently, no specific transfer pricing documentation framework and format have been provided for MNE group members with revenues below the EUR 50 million materiality threshold (to be considered on the basis of the two preceding financial years) in Austria.

The draft TPG 2020 sets out the minimum requirements for transfer pricing documentation outside the scope of the Transfer Pricing Documentation Law requiring that documentation covering the minimum content is prepared contemporaneously. The new content requirements largely are in line with those applicable for a Local File. The minimum standard requires that the international value chain is presented and that written intercompany agreements are in place covering the documented intercompany transactions.

In addition to the requirement for the transfer pricing documentation (regardless of entity size) to be available by the time the relevant tax return is filed, the TPG 2020 emphasizes that support for the determination of arm's-length terms and pricing must be available at the time the relevant transaction is entered into. ***Observation:*** The new minimum standard of contemporaneous documentation requirements likely will lead to more scrutiny of the transfer pricing arrangements of 'smaller' entities operating in Austria.

Corresponding adjustments

The draft TPG 2020 sets out the primary procedural basis for a corresponding adjustment. If the statute of limitations has occurred, this can only be resolved within the framework of a MAP.

The takeaway

The draft TPG 2020 is a major rework of the previous administrative guidance in Austria incorporating 10 years of transfer pricing developments on the level of the OECD (including the BEPS project), as well as in local administrative practice and transfer pricing case law.

The guidance largely is in line with the OECD TPG; however, some aspects introduce stricter requirements or include formulations that may give rise to conflicts of interpretation with other countries in the future. The largest impact of the new guidance is expected to be substantially higher standards with respect to the determination, documentation, and monitoring of the arm's-length nature of intercompany transactions in Austria. This relates to the content of intercompany agreements as well as how intercompany transactions — especially intercompany financing arrangements and those involving intangibles — are to be analyzed and documented in the future. Due to the dynamic interpretation, however, MNEs active in Austria can expect that their past arrangements also would be reviewed against these higher standards in tax audits. Finally, smaller companies also now will be facing stricter formal documentation requirements in Austria.

The only recent OECD-level development not specifically reflected in the draft TPG 2020 is the Guidance on the transfer pricing implications of the COVID-19 pandemic published on December 18, 2020. Therefore, it remains to be seen how Austrian tax auditors will approach the impact of the pandemic on the results of MNE members from a transfer pricing perspective. In In light of the general 'dynamic' interpretation, however, the OECD's latest guidance also may be considered relevant, provided that both the impact of the pandemic as well as how the arm's-length principle was applied are documented contemporaneously. In this context, the transfer pricing treatment of government interventions (subsidies received relating to short-term work, revenues, or fixed costs compensations, etc.) should be considered in light of the transfer pricing model and the functional and risk profile of the Austrian MNE member. Similar to R&D subsidies, such support likely will be seen as a form of "location saving" that cannot automatically be allocated to the principal through the transfer pricing arrangements.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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