

Belgium issues new guidance on application of OECD TP Guidelines - much parallelism, few nuances too

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In brief

The Belgian Tax Administration (BTA) on February 25 issued circular letter 220/C/35 on the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the Circular). The purpose of the Circular is to provide an overview of the Belgian positions toward several Chapters of the 2017 OECD Transfer Pricing Guidelines (the OECD Guidelines), as well as some financial transactions that are part of the 2020 Report on Transfer Pricing Aspects of Financial Transactions.

The circular also contains a brief summary of the general principles of Part I of the 2008 and 2010 OECD Report on the Allocation of Profits to Permanent Establishments (Authorised OECD Approach – “AOA”). The Circular indicates that the BTA adheres to the arm’s-length principle and the OECD Guidelines, and mentions some preferred approaches. However, some differences between the interpretation given in the Circular and the OECD Guidelines are discussed further below.

The Circular generally will apply to transactions from January 1, 2018. For transactions before that date, both the taxpayer and BTA can rely on the guidance and instruments in force at that time, including the international standards. For certain provisions (see discussion below), however, the Circular is applicable only to transactions from January 1, 2020.

BTA’s publication of what it calls its preferred approaches or positions with regard to the OECD Guidelines allows businesses to better prepare adequate transfer pricing policies and approaches.

In detail

Interpretation of the arm’s-length principle

The BTA confirms that it adheres to the arm’s-length principle embedded in the OECD Guidelines. The BTA also refers to the good-faith application of treaties, including tax treaties (Art. 32 of the Vienna Convention on the Law of Treaties of 23 May 1969). It refers to the arm’s-length principle as the international standard for allocating profit and defines associated enterprises in line with Article 9 of the OECD Model tax convention.

Subsequently, the role of transfer pricing is explained in conjunction with the accurate delineation of the transaction and the five comparability factors, taking an analysis of the contractual terms as the starting point. With regard to the assumption of risk, the Circular refers to the six-step approach under the OECD Guidelines.

Observations

The reference to the good-faith application of the arm's-length principle in a treaty context is helpful. However, the Circular does not address how the arm's-length principle is linked to the relevant articles under the Belgian Income Tax Code (BITC), and how it will be interpreted. In particular, with respect to the burden of proof, which in most cases under the BITC lies on the tax administration, the Circular does not seem entirely clear, as it states on multiple occasions that the taxpayer must demonstrate the arm's-length character of the transaction or operation.

The Circular differs from the OECD Guidelines where it indicates that losses can only be accepted for a limited period, and a commercial strategy ultimately should result in profitability or otherwise should be discontinued. The position taken by the BTA seems less nuanced than the guidance in the OECD Guidelines, advocating a more in-depth analysis as to the reason for the losses and whether the return was at arm's length.

According to the Circular, when applying the transactional net margin method (TNMM), subsidies received must be deducted from the cost base/revenue when there is a direct causal relationship between the subsidies received and the production/revenue arising from the sale of goods or services provided. For the OECD Guidelines, the deduction or inclusion of subsidies from the expenses or into revenue, respectively, usually should be determined on the basis of a review of all the relevant facts and circumstances and generally is a matter of comparability, but no general conclusion or approach can be derived. The BTA's divergent interpretation on subsidies seems to depart from an arm's-length approach as put forward in the OECD Guidelines and potentially could result in double taxation for taxpayers.

The BTA indicates that procurement benefits derived from a group synergy setting must be beneficial to all group members. According to the Circular, the compensation for the group member performing sourcing functions must be determined through the profit margin on the operational expenses, whereas the OECD Guidelines also recognise a commission-based remuneration system. The approach mentioned in the Circular hence could result in a transfer price that conflicts with the arm's-length principle. The Circular omits the possibility to undertake a full functional analysis to take into account the specificities of the procurement entity as a prerequisite to decide on the most appropriate transfer pricing remuneration method in the case at hand.

Transfer pricing methods

In general, the transfer pricing methods mentioned in the Circular align with those mentioned in the OECD Guidelines.

Observation

Under the resale price method, the Circular indicates that, in determining the gross margin, one should scrutinize the cost of goods (COGS) sold, as its definition does not match the definition under Belgian GAAP. The Circular may intend to draw attention to differences between local GAAPs when looking at costs 'above or under' the gross profit line in determining the margin and hence concerns the treatment of costs as COGS or operational expenses. It does not seem to address the actual application of the resale price method and margin. The Circular is silent on this issue in the case of application of the cost plus method.

Comparability analysis

The BTA's position broadly aligns with the OECD Guidelines and the nine-step approach on performing a comparability analysis. However, as will be briefly discussed below, there are some differences that may have a material impact.

Note: For transactions from January 1, 2020, the transfer pricing study must be updated every three years. In the event that the facts and circumstances so warrant, an earlier update of the transfer pricing study is needed.

Observations

The Circular requires the taxpayer to demonstrate whether a combined transaction (or splitting a transaction) is aligned with the arm's-length principle. This example of the shifting of burden of proof from the tax administration to the taxpayer generally is not in line with the BITC, as usually the burden of proof lies on the tax administration.

The Circular requires that comparable data cover at least three years for transactions from January 1, 2020. The Circular does not state that the data must be consecutive year data. For the tested party, only the year concerned is considered, which seems to forego the opportunity of analyzing the impact of economic or industry cycles.

For transactions from January 1, 2020, companies facing two or more loss-making financial years will not be considered comparable. This guidance departs from both OECD and EU Joint Transfer Pricing Forum guidance, which adhere to the principle that loss-making companies should not be rejected simply because they are loss-making, but a qualitative analysis must be performed. Further, the Circular does not indicate in what timeframe these loss-making financial years should occur (e.g., during two consecutive years, two years within any three-year or five-year period, or any other approach). By taking this approach, the Circular does not take into effect that loss-making companies could be acceptable comparable companies, and consequently increases the range in a way that may be seen as inappropriate.

Although the BTA accepts the full-range concept, it has a preference for the interquartile range. The BTA accepts an adjustment to the most appropriate point in the range. When such point cannot be determined, however, the BTA prefers to adjust to the median. The OECD Guidelines indicate the median only as an example, and other points such as mean or weighted-averages, depending on the specificities of the transactions, also can be used in cases where unquantifiable deficiencies in the comparable set remain. The BTA therefore seems to limit the available possibilities. The BTA applies this approach for transactions from January 1, 2020.

Special consideration for intangibles

In general, the Circular is aligned with the OECD Guidelines. For hard-to-value intangibles (HTVI), the Circular provides that the BTA under certain circumstances may to rely on ex-post returns of such intangibles as a basis for a rebuttable presumption to verify the ex-ante price setting (the Circular uses the term “rebuttable presumption”; the OECD Guidelines use the term “presumptive evidence”). However, the Circular does not reference to domestic legislation for the use of this approach on HTVI. The country profile of Belgium (updated in 2017) on the OECD website states that Belgium has no domestic legislation or regulation providing for transfer pricing rules or special measures regarding HTVI, but further states that it follows the OECD Guidelines.

Observations

This approach — which comes close to hindsight — raises questions, as the BTA is not obliged to review the facts and circumstances from a two-sided perspective when the transaction occurred. Rather, under certain conditions the BTA allows use of information relating to later years (ex-post information) to assess whether the conditions at the time of the transaction (ex ante) were at arm’s length. It is not clear what legal basis the BTA will rely on to justify adjustments based on information unrelated to the taxable period gathered in later years. This hindsight approach will be used to review intercompany transactions involving intangible assets that occurred as from January 1, 2018 (with the caveat that the BTA can rely on the guidance and instruments in force at that time, including the international standards).

Special consideration for intra-group services

The BTA adheres to the low value adding intra-group services (LVAIGS) approach of the OECD Guidelines. MNEs that have opted this approach should consistently apply this approach in all countries where this approach is accepted.

Observations

The BTA’s approach to LVAIGS refers to the specific relevant guidance in the OECD, but does not refer to the guidance developed by the European Joint Transfer Pricing Forum (JTPF) in its 2011 report on the topic.

Under the JTPF Guidelines, depending on the facts and circumstances, LVAIGS generally will be remunerated with a mark up on costs ranging from 3% to 10%, usually around 5%. The OECD Guidelines recommendation for taxpayers is to implement a single 5% mark-up for LVAIGS.

The BTA’s adherence to the simplified approach for LVAIGS as discussed in the OECD Guidance is helpful. Nevertheless, companies may have been using the JTPF guidance developed in 2011 for some time. The BTA’s position

is unclear as to whether enterprises still can use the JTPF guidance or whether they have to switch and follow the OECD guidance with the fixed 5% mark-up as a return for LVAIGS.

Cost contribution arrangements

The Circular follows the OECD Guidelines in this respect, including the distinction between development CCAs (development of a tangible or intangible asset) and services CCAs (rendering a service). With respect to the use of costs for valuing the contribution to the CCA, the Circular indicates that, in exceptional cases, where the difference between the costs and the value of the contribution is minimal, costs can be used, and adds that this model often is used for development CCAs.

Observations

The guidance in the Circular differs from the OECD Guidelines on the use of costs for valuing the contribution to the CCA. The OECD Guidelines indicate that where the difference between the value and costs is relatively insignificant, for practical reasons, current contributions of a similar nature may be measured at cost in such cases for services CCAs (§ 8.28 OECD Guidelines). The application of the guidance of the Circular on the use of costs for valuing contributions for development CCAs may lead to differences in approach applied by other countries, leading to possible disputes and double taxation.

Financial transactions

The Circular discusses a limited number of issues that the BTA will consider when reviewing financial transactions: intra-group loans, intra-group guarantees, and cash pooling.

Regarding credit rating, the BTA will accept the use of available tools in the market to determine the credit rating of group companies.

Regarding intra-group loans, the BTA prefers the use of the (internal or external) CUP method. If the CUP method cannot be applied, the interest rate should be constructed on the basis of the following elements (non-exhaustive list):

- determining the base interest rate (e.g. LIBOR or EURIBOR for loans of up to one year);
- duration of the loan;
- credit rating of the borrower;
- amount and currency.

The Circular considers that cash pool structures generate synergies and that the participants should benefit from those synergies.

Observations

The criteria mentioned above seem to reflect a preference for the use of an external CUP. The question arises whether the BTA prefers an internal to an external CUP, despite the fact that the selection of the most appropriate method should be the decisive criterium.

The Circular does not address other methods for determining the interest for intra-group loans, such as loan fees and charges, cost of funds, or credit default swaps, discussed in the 2020 OECD Transfer Pricing Guidance on Financial Transactions in Chapter X of the Guidelines. It is unclear whether the BTA will endorse the use of such approaches.

Regarding intra-group guarantees, the Circular only indicates that where the guarantee may allow the borrower to benefit from better loan conditions, a remuneration for the guarantee is appropriate. The BTA favors the yield approach for determining such remuneration.

Observations

The Circular does not clarify the position of the BTA in cases where the guarantee does not only allow the borrower to benefit from better loan conditions but also to increase its borrowing capacity. It does not address other approaches for determining the remuneration for guarantees of loans such as CUP, cost approach, valuation of expected loss approach (CAPM), or capital support method.

The Circular discusses issues related to notional or physical cash pooling. According to the BTA, all participants to the cash pool are a guarantor for each other and can be considered having the same rating. Further, the synergy effects must be ceded to the participants. Unless a functional analysis reveals otherwise, the BTA considers that the cash pool leader is a service provider remunerated on the basis of a cost-based method. When a participant in the cash pool has the same position (positive or negative) during a period of 12 months, the BTA considers that the lowest constant position of the participant in the cash pool represents a loan or a borrowing from the cash pool.

Observations

The approaches taken in the Circular seem to depart from common business practice. Although the Circular starts with referring to the new Chapter X, OECD Guidance on Financial Transactions, the positions taken in the Circular are not fully aligned. More in particular, the OECD enumerates various types of synergies that can benefit the participants. The Circular expects that the participants benefit from synergies related to netting debit and credit positions as well as better bank conditions. The OECD, however, also refers to other synergies that could be sufficient to participate in the cash pool (e.g., access to liquidity).

Permanent establishments and transfer pricing

The BTA addresses profit allocation to permanent establishments (PE) in this section of the Circular. It contains only the basic high-level principles discussed in Part I of the 2008 and 2010 versions of the OECD papers concerned: hypothesizing the PE as a separate and distinct enterprise (step 1) and allocating profit by applying the OECD Guidelines by analogy (step 2).

Observations

We assume that, through the publication of the limited guidance on PE profit allocation, the BTA signals it will apply the AOA for the purposes of Article 7 (business profits) of the double tax treaties concluded by Belgium. However, not all countries adhere to the AOA.

Status of the Circular

In Belgium, a Circular expresses the positions and approaches of the BTA. Civil servants of the BTA have to adhere to them and apply them. For the taxpayer, it is an indication on how the BTA will approach certain situations or transactions. However, the Circular is not binding on taxpayers or on Courts and Tribunals. As a result, the taxpayer can consider or defend a different position than the one taken in the Circular. Ultimately, the decision on whether the approach or position taken by the BTA in the Circular is the correct interpretation of tax law and regulations will depend on the Courts and Tribunals.

BTA's application of the Circular

The retroactive application of the Circular for transactions from January 1, 2018 seems reasonable, as most enterprises already will have aligned their transfer pricing policies to the BEPS Action 8-10 Report published in October 2015 and to the 2017 Guidelines. Other approaches only will be applicable to transactions concluded as from January 1, 2020.

A cause for potential concern is the statement that, for transactions concluded before January 1, 2018, both taxpayer and BTA can rely on the guidance and instruments in force at that time, including international standards. This can be interpreted as if the BTA could rely on guidance developed in the BEPS Action 8-10 Report of 2015, for example, as part of a dynamic interpretation, even though the positions of the BTA were not known yet. That also could suggest that the BTA could challenge an arm's-length transfer pricing policy that was developed before the publication of the relevant BEPS reports and that has been consistently applied. It would have been preferred that the BTA had clarified that in

cases where the taxpayer applies the BEPS Action 8-10 Report before January 1, 2018, the BTA will follow suit, and it will not challenge arm's-length approaches that are based on international guidance that was developed before October 2015, and that have been consistently applied.

The takeaway

The Circular marks a new stage to the BTA's growing interest in transfer pricing. The transparency displayed is welcomed and should help to increase certainty, in particular where the Circular aligns with the OECD Guidelines. However, as the BTA differs from the OECD Guidelines on several points, the possibility of double (or multiple) taxation and national or international disputes cannot be ruled out.

It is recommended that MNEs list potential differences between the positions taken by the BTA in the Circular versus the current transfer pricing policies involving their Belgian group affiliates. For each deviation, a fair assessment should be made whether the MNE's position is sustainable given the OECD Guidelines and the BITC. Ultimately, the best remedy to prevent potential disputes remains to have sound transfer pricing policies assorted with adequate documentation (including master file and local file) demonstrating a consistent value chain approach in line with the arm's-length principle.

Let's talk

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

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