

Observations on key changes to Austria's revised Transfer Pricing Guidelines

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In brief

Following the publication of Austria's draft Transfer Pricing Guidelines (draft ATPG) in 2020, the Austrian Federal Ministry of Finance issued the final Austrian Transfer Pricing Guidelines (ATPG 2021 or Guidelines) in October 2021. The ATPG 2021 extensively revise the 2010 Transfer Pricing Guidelines (ATPG 2010) and aim to reflect the OECD BEPS project-related developments, latest jurisprudence, and administration practice in Austria.

This insight provides a comprehensive overview of the key changes in the final ATPG 2021 compared to the draft ATPG, as well as the ATPG 2010.

Action item: Businesses should assess whether their transfer pricing policies comply with the updated ATPG 2021, especially relating to areas where the updated guidance substantially differs from what was included in the ATPG 2010 — e.g., intercompany financing, secondments, or transactions involving intangibles.

In detail

Overview

The ATPG 2021 are substantially in line with the 2017 OECD Transfer Pricing Guidelines (OECD TPG) and amendments, such as the Revised Guidelines on the Application of Profit Split Methods from 2018 and Transfer Pricing Guidance on Financial Transactions issued in February 2020 (2020 OECD Report on Financial Transactions). However, the ATPG 2021 differ in emphasis or interpretation in a number of important areas, which may lead to tax audit disputes for multinational enterprises (MNEs) operating in Austria.

The ATPG 2021 acknowledged the OECD TPG as being an instrument to aid the interpretation of double tax treaties and the arm's-length principle set out in domestic law. The ATPG 2021 are to be used in their latest applicable version when interpreting the arm's-length principle, i.e., using a "dynamic interpretation." 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 that was in place when the parties entered into the transaction in question be used. As a result, the ATPG 2021 foresees a dynamic interpretation, which means that MNEs can expect that past periods under tax audit will be reviewed in light of subsequently issued guidance on OECD level and their interpretation in ATPG 2021.

Observation: Some intercompany arrangements may now 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 ATPG 2021 raise the bar with regard to the 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. However, in contrast to the draft ATPG, the ATPG 2021 mention that in case written contracts are not available, the terms and conditions should be inferred from the actual conduct of the parties involved.

The necessity of concluding contracts in advance is explicitly referred to, for example, in connection with cost contribution arrangements and cost allocation arrangements, loans, and contracts in connection with the license or transfer of intangible assets. Similarly, the section dealing with the documentation requirements for companies not falling under the scope of the Transfer Pricing Documentation Act refers to written contracts concluded in advance of the transaction as well as in the context of year-end adjustments.

Observation: In seeking to avoid potential nonrecognition of intercompany transaction terms or delineation of transactions not in line with the parties' intentions, it is recommended that intercompany agreements expressly and clearly address all transfer pricing relevant terms in writing. However, this may limit flexibility in their application over time and require that intercompany contractual terms are kept up-to-date with business practice and developments.

Transfer pricing methods

The ATPG 2021 generally follow 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. One point of difference concerns the application of the Transactional Net Margin Method (TNMM), whereby the ATPG 2021 do not allow for pass-through expenses in the cost base for the calculation of the profit margin. 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.

The new ATPG 2021 mention that while certain comparable transactions may be analyzed on an aggregated basis, the TNMM should not be applied together for different business areas (e.g., manufacturing and distribution). Also, no global formulaic profit allocation can be applied. The ATPG 2021 apply high standards to the application of the TNMM in benchmarking analysis — i.e., in terms of comparability — and require that details of manual search steps, including financial information of accepted and rejected companies, be available.

With respect to the Profit Split method, in addition to the OECD Revised Guidelines on the Application of Profit Split Methods from 2018, the ATPG 2021 also refer to the 2019 EU Joint Transfer Pricing Forum report on 'The application of the profit split method within the EU' as guidance for interpretation.

Arm's-length results

The ATPG 2010 introduced clear guidance on tax audit adjustments, stating that prices that fall outside the arm's-length range must be adjusted to the median. While the draft ATPG would have maintained this approach, the final Guidelines introduced a significant modification, requiring only for results that fall outside the arm's-length range to be adjusted to a point within the range. The median is mentioned as the point reflecting central tendency in this context, but the ATPG 2021 allow for the possibility that tax authorities deem a point other than the median as more appropriate. At the same time, the formulation of what constitutes the arm's-length range has been aligned with that of the OECD TPG.

Observation: In the past, tax authorities interpreted the 'arm's-length range' strictly as the interquartile range (unless there was a very limited number of comparables identified). The final Guidelines may allow room to argue for less restrictive limitations, such as use of the inter-decile range or full range. At the same time, the case-by-case

approach may be used by tax authorities to argue for a more aggressive position compared to what an adjustment to the median would have represented. Routine entities operating in Austria therefore should continue to monitor the development of profits to avoid actual results falling outside the arm's-length range.

Year-end adjustments

The ATPG 2021 adhere to the ex-ante approach, which means that there should be support for the chosen price at the time of price setting. Year-end adjustments must be made to a point that is within the arm's-length range and are permissible only if the following criteria are cumulatively met: (1) the ex-ante price setting is subject to significant uncertainty; (2) reasonable efforts have been made during the year to achieve arm's-length prices (continuous monitoring); and (3) factors that might influence the price setting were agreed in advance. The condition applied in tax audit practice in the past — that year-end adjustments only are permissible from a point outside the interquartile range — no longer applies.

Observation: Prior Austrian tax audit practice routinely disallowed year-end transfer pricing adjustments that moved the taxpayer's results from a point within the interquartile range of benchmarked results to a particular target in the range. This created problems for many MNEs that steer the results of routine entities toward a consistent outcome taking advantage of year-end adjustments. The updated wording is an important change in this regard, allowing companies to target a particular result or narrow range of results within the arm's-length range. It is recommended that end-year adjustments be explicitly allowed for in the contractual arrangement and that evidence is available demonstrating that prices are continuously monitored and, if necessary, adjusted during the year. In the absence of such documentation, there is a risk that year-end adjustments would not be recognized for tax purposes on the basis of the formal requirements included in the ATPG 2021.

Intra-group services

The concept of low value-adding intra-group services (LVAIGS) and the related simplified documentation rules in line with the OECD TPG are introduced in the ATPG 2021. Based on this, a safe harbor of a 5% cost-plus markup can be applied for LVAIGS, generally covering support services that are not part of the core business of the group, do not create or use unique and valuable intangible assets, and do not relate to the management or control of economically significant risks. The list of typical activities that may and may not constitute LVAIGS, as well as the specific documentation requirements, reflect the relevant provisions of the OECD TPG.

Regarding '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% net margin based on the 2010 EU-JTPF's report on low-value adding services. The 5% to 15% gross margin range still can be applied for services performed before January 1, 2022. However, the new remuneration of 3% to 10% is not a safe harbor, and an economic analysis still should be performed in order to support the actual markup applied.

The ATPG 2021 specifically address 'non-routine' intercompany services that utilize self-developed intangible assets or provide important contribution into the value chain, such as research and development (R&D) services. The ATPG 2021 suggest that it has to be analyzed if the cost-plus method can be applicable at all for such services or the use of another method, such as transactional profit split, is warranted. Where the cost-plus method is applicable, a new example included in the ATPG 2021 implies that the remuneration in case of non-routine services is expected to be above the 3% to 10% range.

Observation: The lowering of the indicative range of margins for routine services is an important acknowledgment that the arm's-length margin for certain routine services may be below 5%. At the same time, the lack of clarity with respect to what constitutes non-routine services, and under what circumstances they can be remunerated on a cost-plus basis, may lead to tax audit disputes. In any case, it appears likely that tax auditors will expect markups above 10% for a range of intercompany services including R&D, services of senior management, or those relating to entry into new markets. Preparing robust benchmarking analyses will be necessary for companies wishing to argue for a different position.

Cost contribution arrangements

In line with the update of Chapter VIII of the OECD TPG, the ATPG 2021 introduce stricter requirements with regard to the formation of and participation in cost contribution arrangements (CCAs) by associated enterprises. The determination of arm's-length remuneration in the context of CCAs also was revised in line with the OECD TPG, limiting the possibility to charge costs without a markup to activities where the arm's-length value is not materially different from the cost incurred (e.g., LVAIGS). **Observation:** It is important to accurately document the risks, responsibilities, and expected benefits of each participant to a CCA.

Financial transactions

Previous guidance on intercompany financial transactions has been completely revised, largely in line with the 2020 OECD Report on Financial Transactions.

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

Observation: The most important change in the ATPG 2021 is that the arm's-length principle also serves to distinguish between equity and debt; in other words, partial recharacterization of debt now is made possible. Compared to the OECD's guidance, the ATPG 2021 place more emphasis on formal elements in this regard, such as missing contractual elements. Possible ground for nonrecognition of intercompany financing as loans for tax purposes might include the borrower's 'difficult economic situation' or missing or long-term repayment of the principal; however, the ATPG 2021 call for taking a holistic view of all relevant facts.

References to possible sources of external or internal comparable information for pricing of intercompany debt are generally in line with the OECD's guidance. Previous guidance on the non-acceptability of pricing quotes from commercial banks has been revised, stating that specific pricing offers that have gone through credit committee approval may be used as comparable information. Lastly, lenders that do not control and manage financing risks may receive only a risk-free return.

With regard to cash pooling structures, the ATPG 2021 confirm the view already set out in the ATPG 2010, according to which the cash pool leader generally has a low function and risk profile and should be remunerated on the basis of the cost-plus method, whereas cash pool members are entitled to the synergy effects.

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 have to be documented carefully and market developments may have to be monitored continually in the case of longer-term arrangements. While the guidance is substantially in line with that of the OECD, there are several differences in emphasis and formulation which may lead to tax audit disputes in the future. For instance, Austrian tax authorities 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 and hard-to-value intangibles

The ATPG 2021 follow the updated Chapter VI of the OECD TPG, introducing the 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 (HTVI), is in line with the OECD TPG. This suggests 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, while the legal owner of intangible assets that outsources all DEMPE functions and does not exercise

control over the outsourced functions is not entitled to the return from the exploitation of such intangibles but instead should get a routine remuneration for services provided. Compared to the ATPG 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.

Observation: In contrast to the draft TPG, which foresaw that the concept would only be applicable after January 1, 2021, dynamic interpretation is applied in case of HTVI. It is important to bear in mind that transactions involving HTVIs give rise to reporting obligations under the DAC-6 Directive, and potentially allow tax authorities to adjust intercompany pricing with the benefit of hindsight under certain circumstances.

Group restructurings

Guidance on business restructurings is substantially in line with 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.

In addition to (tangible or intangible) assets, a business restructuring may involve the transfer of a business activity ("ongoing concern"). In this context, the transfer of a business activity — i.e., a functioning, economically integrated business unit — means the transfer of assets, together with the ability to perform certain functions and assume certain risks. The ATPG 2021 explicitly link the OECD concept of transfer of an "ongoing concern" with the domestic definition of a "business" or "business unit" in the context of the application of the arm's-length principle in business restructurings.

Intra-group lease of personnel

The ATPG 2021, for the first time, make statements on the transfer pricing methodology in the case of intra-group secondments, distinguishing between "passive" and "active" services. If there is a genuine transfer of personnel (passive service), the arm's-length remuneration generally is to be determined on the basis of an (internal or external) CUP or the cost-plus method. Under the cost-plus method, all costs associated with the secondment and, if applicable, an arm's-length profit markup must be considered. From the perspective of the receiving company, it must be considered whether personnel with the same skills and knowledge are available on the local labor market and what expenditure would have to be made for this.

Observation: In the absence of specific guidance, secondments often were charged at cost in the past as opposed to intercompany services, where a markup was applied. Companies now will have to assess whether their current approach to employee leases for transfer pricing purposes must be adjusted to align with the new ATPG 2021. Recipients of high-cost leased personnel may have to prepare additional documentation to justify the level of expenditure considering the availability of resources on the local market.

Group synergies and location savings

Rules regarding group synergies and location savings due to the market-specific characteristics are 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. The ATPG 2021 specifically refer 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 by performing a functional analysis and considering the parties' relative negotiating positions.

When considering realistically available alternative options, intercompany parties must assess whether third parties would have passed on the cost advantage to foreign principals via more favorable transfer prices. Based on the example cited in the ATPG 2021, an R&D service provider should not reduce the cost base with R&D subsidy received for the purposes of determining the intercompany service charge if it has a strong bargaining position due

to a lack of comparable competition, or in cases where the comparable companies identified do not grant a price discount due to the research premium received.

Observation: Companies acting as R&D service providers that receive R&D subsidies in Austria should review how the subsidies are considered in the service charge. Putting in place robust documentation in case the intercompany services are charged net of R&D subsidies received would be necessary. Further, it is likely that the Austrian tax authorities will treat COVID-related subsidies (such as short-term work, fixed cost compensation, or compensation for lost revenues) following the principles outlined above with respect to R&D subsidies.

Permanent Establishment (PE) profit allocation

The concept of 'AOA light' is introduced with respect to the profit attribution to PEs. According to this, the principles of profit allocation between a head office 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 head office and a PE and costs related to services provided outside the group's core business activities have to be allocated without a markup.

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 ATPG 2021 refer to the possibility of resolving the taxation conflict within the framework of a mutual agreement procedure (MAP).

Documentation

The Austrian Transfer Pricing Documentation Law requires that only constituent entities (including PEs) above the applicable materiality thresholds 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 based on the two preceding financial years) in Austria.

The ATPG 2021 set 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 ATPG 2021 emphasize that support for the determination of arm's-length terms and pricing has to be available at the time the relevant transaction is entered into.

The Austrian Transfer Pricing Documentation Law contains a notification obligation with respect to Country-by-Country reporting. For fiscal years starting after December 31, 2021, such notification needs to be submitted only if there were changes to the notification submitted in the previous year.

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 ATPG 2021 set 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

ATPG 2021 represent a major rework of the previous administrative guidance in Austria, incorporating 10 years of transfer pricing developments at 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, but in some respects introduces stricter requirements or includes formulations that may give rise to conflicts of interpretation with other countries. 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. Also, due to the dynamic interpretation, MNEs active in Austria can expect that their past arrangements will 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 reflected specifically in the ATPG 2021 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 light of the general “dynamic” interpretation, it appears that the OECD’s latest guidance also would 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.

Let's talk

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

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