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Global Tax Alert

News from Transfer Pricing

Belgian Tax Authorities issue new circular on transfer pricing

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Executive summary

The Belgian Tax Authorities (BTA) published, on 25 February 2020, a new circular (2020/C/35) with guidance on transfer pricing for multinational enterprises and the tax administration (TP Circular or circular). The purpose of the circular is to provide an overview of the principles of the 2017 Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines) and the specific positions of the BTA. The TP Circular can be consulted in Dutch or French.

The TP Circular, which generally follows the principles of the OECD Guidelines, sets forth the BTA's interpretation, preferred approach and position on certain of those principles. Hence, Multinational Enterprises (MNEs) with intercompany transactions with Belgian entities or permanent establishments (PEs) should review the impact of the TP Circular on their transfer pricing policies.

The TP Circular is applicable to transactions as of 1 January 2018, except for: (i) certain specific considerations for benchmarking analyses and transfer pricing adjustments; and (ii) considerations on financial transactions as described in chapter X of the TP Circular and the OECD Guidelines, which are both applicable to transactions that take place as of 1 January 2020. The circular also states that any future changes to the OECD Guidelines can be assumed to be generally followed by the BTA. With the 2020 transfer pricing

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"audit wave" of the BTA being underway at the time of the publication of this Alert, it will be key to take into consideration the guidance of the TP Circular.

The TP Circular also refers to other existing Belgian transfer pricing guidance in various circulars. Hence, the TP Circular co-exists with previous guidance.

Detailed discussion

The remainder of this Alert summarizes some key positions and clarifications of the BTA, which are not found in the OECD Guidelines.

Chapter I: The arm's-length principle

The TP Circular refers to the comparability analyses and the use of the comparability factors of the OECD Guidelines, as the basis for the application of the arm's-length principle. It also stresses the need for an accurate delineation of the transaction and a detailed functional and comparability analysis. While the contractual conditions between the parties are the starting point of the transfer pricing analysis, the TP Circular confirms that the conduct of the parties will prevail if the contractual conditions deviate from such actual conduct. The BTA also confirm the OECD guidance on the notions of risk control and allocation of profits. The BTA indicate that the profit split method can be an appropriate method in the case that more than one entity controls the risks and has the financial capacity to assume these risks.

As it relates to government policies and subsidies, the TP Circular clarifies the BTA's position on how to treat certain taxes levied for the pharmaceutical industry for transfer pricing purposes. In addition, they provide guidance regarding when grants or subsidies can be taken as a reduction of the cost basis in the calculation of the transfer prices.

In its section on group synergies, the BTA states that central procurement centers should be compensated on a cost-plus basis, unless the taxpayer can demonstrate the value-adding character of the procurement center and the benefits for the recipients.

Chapter II: Transfer pricing methods

The BTA recognize that there is no real hierarchy in the various transfer pricing (TP) methods. However, if more methods can be applied with a similar level of reliability, a traditional transaction method (Comparable Uncontrolled Price (CUP) method, Resale Price method or Cost-Plus method) is preferred over the transactional profit methods (Transactional Net Margin method or Profit Split method). The CUP method is preferred if it provides the same level of reliability as other TP methods. If a method other than one of the proscribed OECD methods would be selected, the TP Circular indicates that taxpayers are subject to a higher documentation burden to justify the use of such other method.

The BTA recognizes that the Resale Price method and Cost-Plus method can sometimes be difficult to apply given the absence of aligned accounting information in different countries. The TP Circular also includes some specifications on the calculation of the cost of goods sold or gross margin from the Belgian GAAP numbers. Furthermore, it also clarifies that in the application of the Transactional Net Margin method, diligence is required in the proper calculation of the operating profit. Especially as it relates to the treatment of non-recurring operating/financial items, the TP Circular calls to preserve the comparability for the calculation of the operating profit (given the changes in the accounting plan as a result of the Royal Decree of 18 December 2015 and the European Union (EU) Directive 2013/34/EU). This will be relevant for both the set of comparable companies used and testing the taxpayer's results. However, the TP Circular does not provide detailed guidance on the implementation aspects.

The TP Circular also provides further details on the cost basis to use in the application of a cost-plus methodology. If budgeted costs are used, the BTA will verify deviations from the actual costs and the arm's-length nature of such deviations.

Chapter III: Comparability analysis

The TP Circular refers to the nine steps of the OECD guidance to perform a comparability analysis and provides the BTA's guidance and point of view regarding each step (outlined below).

- A minimum period of three years of comparable data should be used to compare to the tested party data of the year under review for the evaluation of an arm's-length price or return.
- It reconfirms its acceptance of intentional set-offs, provided that the individual transactions occur at arm's length.
- The TP Circular attaches great value to the quality of the comparables, rather than to the quantity of them. The search process used needs to be transparent, systematic and verifiable. It is also confirmed that internal comparables may prove to be the better comparable in some cases.

- The BTA express a preference for the application of diagnostic ratios, rather than the use of comparability adjustments. They call for prudence with too many comparability adjustments and provide guidance in this respect.
- A yearly update of the comparability analysis or benchmark is recommended, with a new study every three years.
- Regional searches should be considered only if there are not (enough) comparable data on the tested party's jurisdiction. The BTA accept pan-European studies.
- For limited risk profiles, the BTA does not accept comparable companies with more than two loss-making years. Also for start-up companies, they invoke certain standards to increase comparability.
- If the tested party realizes a result outside the range, a correction will be made unless the taxpayer can support this deviation. This adjustment needs to be done to a point in the range which reflects the facts and circumstances. If this cannot be done, the BTA has a preference for the median.

Chapter IV: Administrative approaches to avoid and resolve transfer pricing disputes

The TP Circular refers to Circular 2018/C/27 of 7 March 2018 on dispute resolution regarding double tax treaties as well as the FAQs (frequently asked questions) on Advance Pricing Arrangements.

Chapter V: Documentation

The TP Circular refers to Articles 321/1 till 321/7 of the Belgian Corporate Income Tax Code 1992 introducing mandatory TP documentation filings in Belgium in the framework of Base Erosion and Profit Shifting (BEPS) Action 13 (Circular 2017/C/56) and the "BEPS 13" website of the Belgian government that provides additional guidance.

Chapter VI: Special considerations concerning intangible assets

The guidance in the TP Circular is generally aligned with the OECD Guidelines on the identification of intangible assets, ownership and the determination of a transfer price. Regarding valuations, the BTA also refer to other valuation techniques than the discounted cash flow method. Consistent with the OECD guidance, the BTA questioned the relevance of valuations made for other purposes than for transfer pricing. The rationale for the selection of the valuation method needs to be detailed in the TP documentation.

The BTA also describe their view on the transfer of hard to value intangible assets (HTVI). A detailed analysis and more extensive documentation need to be prepared to demonstrate that all factors have been taken into account. The BTA indicate that they aim to detect such HTVI transactions as soon as possible. The TP Circular also stresses that the BTA will cooperate to help to resolve double taxation under the application of the Mutual Agreement Procedure in the relevant treaties or the EU Arbitration Convention.

Chapter VII: Special considerations regarding intra-group services

The chapter generally follows the OECD Guidelines as it relates to the definition, treatment, quantification and allocation of intra-group services. For service providers with limited risks, the TP Circular indicates that their return should be guaranteed and not be subject to the negative consequences of financial and/or non-recurring costs, which are not aligned with the functional profile of the service provider.

A specific section is dedicated to the simplified approach for the remuneration of low value-adding services also included in the OECD Guidelines. This is considered an optional regime whereby a 5% mark-up can be applied for qualifying low value-adding services, without the requirement of having a benchmark. The BTA however specify that once elected, this simplified approach should be applied by the group in all countries where such approach is acceptable. The application of this simplified approach is subject to some additional requirements from a documentation perspective.

Chapter VIII: Cost Contribution Agreements (CCA)

The chapter discusses CCAs for both services and development of intangible assets. The BTA generally follow the guidance of the OECD but stresses the need for having robust documentation with a specified list of items to be included.

Chapter IX: Transfer pricing aspects of business restructurings

Chapter 9 of the Belgian TP Circular is dedicated to business restructurings, where the BTA is mostly aligned with the OECD Guidelines.

The main topics covered in the TP Circular include the definition of business restructurings, attention points around business restructurings such as reallocation of profit potential between affiliated entities, considerations around the determination of "something of value" and arm's-length compensation e.g., business case, dual perspective, synergies, Options Realistically Available (ORA) aspects, transfer of "valuable" tangible/intangible assets and restructuring costs, as well as TP considerations after the restructuring.

The BTA stresses the need for appropriate TP documentation in case of intercompany business restructurings, however no guidance is given in the TP Circular as to the format or the content of such documentation.

Chapter X: Financial transactions

It is noted in the TP Circular that it follows the guidance of the new chapter X of the OECD Guidelines, which became available on 11 February 2020.[1] The TP Circular includes additional specifications on the BTA's position in this respect. In particular, the TP Circular states that the credit rating of a group member can in principle not be higher than the one of the group itself. Furthermore, the TP Circular confirms the acceptability of public credit rating tools, while the OECD stresses some of the limitations in the use thereof. With respect to cash pool transactions, the TP Circular insists on an accurate delineation and hence the proper characterization of the cash pool balances. The TP Circular is, however more specific than the OECD Guidelines and applies a 12-month limitation rule for a potential requalification of the cash pool balances into term loan type of transactions.

Chapter XI: Permanent establishments and transfer pricing

The TP Circular provides confirmation that the BTA follows the Authorized OECD Approach for the attribution of profit between a head office and its PE(s). Reference is made to the 2008 and 2010 reports published by the OECD on this subject, and a summary of the two-step approach is included. For the attribution of free capital to a PE, the BTA expresses its preference for the use of the "capital allocation approach" from the several methods suggested by the OECD. The TP Circular highlights some key differences in the treatment of interest and royalty payments between head office and PE under double tax treaties based on the OECD Model Tax Convention prior to 2010 versus those based on later versions.

Endnote

1. See EY Global Transfer Pricing alert, *OECD releases final transfer pricing guidance on financial transactions*, dated 11 February 2020.

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