

The Arm's Length Standard: a Blind Spot in the CC(C)TB Proposals

Amsterdam, 27 January 2017
The Return of the CC(C)TB: First Critical Analysis

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“Menu” for the next 20 minutes…

- What arm’s length principle are we talking about?
- What is the nature of this arm’s length principle (income allocation, anti tax avoidance, double taxation avoidance, something else?)
- Arm’s length principle and the international allocation of the common tax base (= formula)
- Arm’s length principle and the determination common tax base
- Conclusion

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Is there such a thing as a European arm's length standard? Some indications… (1/1)

- CJ/TFEU freedoms: Lankhorst Hohorst, Thin Cap GLO, SGI
  - Transaction that is not compliant with the domestic arm's length standard, may still be compliant with European standard

- Council/Article 5 Anti-BEPS Directive: exit tax duty & step up 'right' against "**market value**"
  - The amount for which an asset can be exchanged or mutual obligations can be settled between willing unrelated buyers and sellers in a direct transaction

- EC/State aid: e.g. EC Decision 11 January 2016 on Belgian excess profit rulings, para. 150:
  - "… for any avoidance of doubt, the **arm's length principle that the Commission applies in its State aid assessment is** not that derived from Article 9 of the OECD Model Tax Convention and the OECD TP Guidelines (…) but **a general principle of equal treatment in taxation** falling within the application of Article 107(1) of the Treaty, which binds the Member States and from whose scope the national tax rules are not excluded…"

And if so, what is the nature of this European arm's length standard? (1/3)

- Mere international income allocation rule, anti tax avoidance (or anti profit shifting) rule, double taxation avoidance rule?...
  - CJ in Lankhorst Hohorst, C-324/00, Thin Cap GLO, C-524/07 & SGI, C-311/08
    - Anti avoidance / anti profit shifting (paras 37-38, para. 75 and paras 71-72 respectively)
  - Article 5 anti-BEPS Directive: host country must accept FMV of exit country, unless it disagrees with the FMV as determined by the exit country
    - Seems to be primarily concerned with international income allocation and double taxation avoidance

And if so, what is the nature of this European arm's length standard? (2/3)

- International income allocation rule, anti avoidance (profit shifting) rule or avoidance of double taxation rule?...
  - EC Decision 11 January 2016 on Belgian excess profit rulings, para. 177:
    - "The Commission recalls that the application of the arm's length principle by tax administrations is ***primarily* meant to prevent companies** that are part of an international group from being able **to influence** transfer prices and thus **profit allocation between them**"
  - EC Decision 11 January 2016 on Belgian excess profit rulings, para. 178:
    - "**A downward transfer pricing adjustment** leading to a tax reduction **is *only foreseen*** (not required) under the arm's length principle in the exceptional situation where it is a corresponding adjustment following a primary adjustment in another tax jurisdiction, i.e. **on a symmetrical basis**"
    - Hence: avoidance of double taxation only a subsidiary objective

And if so, what is the nature of this European arm's length standard? (3/3)

- … or always single taxation *somewhere*? *Cf*. EC Decision 30 August 2016 on Irish rulings granted to Apple, para. 451:
  - "… **a restatement** could also result from a retroactive modification of the jurisdiction in which the EMEIA sales of ASI are recorded where
    - (…) **risks have been effectively borne in jurisdictions where a more substantial economic activity was taking place than in Ireland** (…)
    - and that **profits subjected to taxation in Ireland are reduced** not more than **proportionately to the corresponding amounts of profits subjected to taxation in [the other jurisdiction]**"

Interim conclusion (1/1)

- We can establish that:
  - A European arm's length standard does exist under current EU law…
  - … and that this standard can deviate from national arm's length standards…
  - … but currently it is hard to say what the European arm's length standard requires, permits and disallows

- Is this unclarity removed by the CC(C)TB proposals….?

The international allocation of the common tax base (= formula) and the arm's length standard (1/2)

- Explanatory memorandum CCCTB-proposal:
  - **Transfer pricing rules would not apply within the group**, as the **distribution** of the group-wide revenues would be carried out **through the formulary apportionment**
  - Since these [formula] factors (**assets, labour, and sales**) are attached to where a company earns its profits, they are **more resilient to aggressive tax planning practices than the widespread transfer pricing methods** for allocating profit

The international allocation of the common tax base (= formula) and the arm's length standard (2/2)

- Article 9 CCCTB: Elimination of intra-group transactions

- Labour: Article 33(5) CCCTB
  - Payroll costs shall be valued at the amount of expenses that are treated as deductible by the employer in a tax year

- Assets: Article 36 CCCTB
  - Mandatory **valuation rules** (IP = excluded)

- Sales (by destination): Article 37(2) CCCTB
  - Shall be valued in accordance with Article 20 of the CCTB Directive (valuation against **market value**)
  - Intra-group sales of goods and supplies of services are excluded from the sales factor

The determination of the common tax base and the arm's length standard (1/2)

- Preamble (14) CCTB-proposal: **To avoid the base erosion** of higher tax jurisdictions through shifting profits via inflated transfer prices towards lower tax countries, **transactions between a taxpayer and its associated enterprise(s) *should* be subject to pricing adjustments in line with the 'arm's length' principle**, which is a generally applied criterion

  - Article 57(1): Where conditions are made or imposed in relations between associated enterprises that differ from those that would have been made between independent enterprises, any income that would have accrued to the taxpayer but because of those conditions has not so accrued, **shall** be included in the income of that taxpayer and taxed accordingly

The determination of the common tax base and the arm's length standard (2/2)

- Article 20(1) [valuation]: The tax base shall be calculated on the basis of the following elements: (…) **the market value**, where the consideration for the transaction is wholly or partly non-monetary; (…) **the market value**, in the case of a non-monetary gift (…)

- Article 29(1) [exit tax]: An amount equal to **the market value** of transferred assets, at the time of exit of the assets, less their value for tax purposes, shall be treated as accrued revenues in any of the following circumstances (…)

- Article 4(18) CCTB: **'market value' means** the amount for which an asset can be exchanged or mutual obligations can be settled between willing unrelated parties in a direct transaction

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Conclusion (1/1)

- CC(C)TB proposals will not fully replace the arm's length principle
- At the same time, the CC(C)TB proposals give little guidance on how the arm's length standard should be applied
- Like under current EU law developments, the arm's length principle remains a blind spot under the CC(C)TB proposals

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