



**EUROPEAN COMMISSION**  
DIRECTORATE-GENERAL  
TAXATION AND CUSTOMS UNION  
Indirect Taxation and Tax administration  
**Value added tax**

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**VALUE ADDED TAX COMMITTEE**  
**(ARTICLE 398 OF DIRECTIVE 2006/112/EC)**  
**WORKING PAPER NO 923**

**QUESTION**  
**CONCERNING THE APPLICATION OF EU VAT PROVISIONS**

**ORIGIN:** Commission

**REFERENCES:** Articles 2(1), 72, 73, 80, 83 and 85

**SUBJECT:** Possible VAT implications of Transfer Pricing

## **1. INTRODUCTION**

The Commission services wish to discuss with the VAT Committee the possible VAT implications of transfer pricing rules laid down for the purposes of direct taxation. Such rules are aimed at ensuring that the conditions of the transactions within a multinational enterprise group ("MNE group"), including the price, match comparable market conditions and that profits are fairly divided between the jurisdictions in which a multinational enterprise ("MNE") operates<sup>1</sup>.

Hence, it is worth examining whether the application of such transfer pricing rules could have VAT implications for Member States, in an attempt to provide legal certainty for businesses and tax administrations.

The Organisation for Economic Co-operation and Development (OECD) and the G20 member countries have undertaken a project to tackle Base Erosion and Profit Shifting (BEPS project), which deals in part with some transfer pricing issues. However, it is outside the scope of this document to examine, in particular, the potential VAT implications of the BEPS project outcome.

## **2. SUBJECT MATTER**

### **2.1. What is transfer pricing?**

Prior to examining possible VAT implications of transfer pricing, it is necessary to outline what transfer pricing is about. It should be noted that the below description does not comprehensively cover transfer pricing rules, but only summarises its most essential principles for the purposes of our analysis.

#### *2.1.1. Legal framework*

The cornerstone of transfer pricing rules is the so-called "arm's length principle", as shall be seen in section 2.1.2, which establishes that the conditions of a transaction between associated enterprises must not differ from those which would have governed a transaction between independent enterprises under similar circumstances.

Such principle is set out in Article 9 of the OECD Model Tax Convention<sup>2</sup>, which forms the basis of bilateral tax treaties involving OECD member countries and an increasing number of non-member countries; and makes up part of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations<sup>3</sup> (also referred to as "Transfer Pricing Guidelines" or "TPG"). The Transfer Pricing Guidelines were first agreed in 1995 on the basis of a previous report, and the latest published version dates from 2010.

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<sup>1</sup> Communication from the Commission to the European Parliament and the Council "A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action" [COM\(2015\) 302 final](#), p. 10. For an historical context of transfer pricing rules, see p. 3 of this Communication.

<sup>2</sup> OECD, [Model Tax Convention on Income and on Capital](#), 2014.

<sup>3</sup> OECD, [OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations](#), 2010.

The arm's length principle as outlined in those documents has largely been followed in the domestic transfer pricing regulations, not only of OECD member countries, but also of EU Member States which are not OECD members, and other relevant non-OECD member countries (such as China, India, Indonesia, Russia and South Africa)<sup>4</sup>. Although the OECD guidelines are naturally not binding, they represent the result of long discussions and a certain consensus on the matter. They are thus a point of reference for national tax authorities in applying the arm's length principle, and they are explicitly mentioned in the legislation or administrative guidance of many Member States<sup>5</sup>.

It is worth noting that the United Nations (UN) have also adopted a manual on transfer pricing<sup>6</sup>, more focused on developing countries and broadly based on the same principles as the OECD Transfer Pricing Guidelines. For the purposes of this document, the OECD Transfer Pricing Guidelines will however be taken as reference.

The impact of transfer pricing rules has become more significant for business and tax administrations with the growth in the volume and value of intra-group trade. Moreover, the existing transfer pricing rules have been found to be sometimes misapplied so that they result in outcomes in which the allocation of profits is not aligned with the economic activity that produced the profits<sup>7</sup>.

This is why since 2010, when the latest version of the OECD Transfer Pricing Guidelines was published, further work on transfer pricing has been undertaken in the framework of the BEPS project, which aims at ensuring that profits are taxed where economic activities generating the profits are performed and where value is created<sup>8</sup>. This is organised through a set of 15 Actions<sup>9</sup>, some of which directly concern transfer pricing<sup>10</sup>. As a result of this work, some chapters of the Transfer Pricing Guidelines have been amended<sup>11</sup>.

However, as already said in the introduction, it is outside the scope of this document to examine, in particular, the potential VAT implications of the BEPS project outcome.

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<sup>4</sup> G. Cottani, "Transfer Pricing", Topical Analyses IBFD, 2016, Chapter 1.

<sup>5</sup> R. Lyal, "Transfer pricing rules and State aid", Fordham International Law Journal, vol. 38:1017, 2015, p. 1022

<sup>6</sup> UN, [Practical Manual on Transfer Pricing for Developing Countries](#), 2013.

<sup>7</sup> Final BEPS [Report](#) on Actions 8-10 "Aligning Transfer Pricing Outcomes with Value Creation", 2015, p. 9

<sup>8</sup> OECD, [BEPS Explanatory statement: 2015 final reports](#), 2015, p. 4.

<sup>9</sup> For more information, see OECD [BEPS Actions](#) and the OECD [BEPS Explanatory statement: 2015 final reports](#), 2015.

<sup>10</sup> Notably, Actions 8-10 "Transfer pricing" (intangibles, risks & capital, and high-risk transactions), and Action 13 "Transfer pricing documentation".

<sup>11</sup> On 23 May 2016, the OECD Council approved the amendments to the Transfer Pricing Guidelines, as set out in the final BEPS [Report](#) on Actions 8-10 "Aligning Transfer Pricing Outcomes with Value Creation", 2015; and the final BEPS [Report](#) on Action 13 "Transfer Pricing Documentation and Country-by-Country Reporting", 2015. The amendments approved by the OECD Council translate the measures envisaged by the BEPS project into Transfer Pricing Guidelines. For more information, see [here](#). The OECD is expected in due course to consolidate its Transfer Pricing Guidelines, dating from 2010, in order to reflect the changes triggered by the BEPS project.

At EU level, the Commission has committed to work with Member States and businesses with a view to developing a coordinated and more concrete implementation of transfer pricing rules within the EU, reflecting the economic reality of the Single Market<sup>12</sup>.

It is also worth mentioning the Joint Transfer Pricing Forum<sup>13</sup> (JTPF), which has been set up to assist and advise the Commission on transfer pricing tax matters, and the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises<sup>14</sup> (also known as the "Arbitration Convention").

### *2.1.2. The arm's length principle*

As stated in the OECD Transfer Pricing Guidelines<sup>15</sup>, the arm's length principle is the international transfer pricing standard that OECD member countries have agreed, and which should be used for tax purposes by MNE groups and tax administrations.

The authoritative statement of the arm's length principle can be found in paragraph 1 of Article 9 of the OECD Model Tax Convention.

*"Article 9*  
*Associated enterprises*

*(...)*

*Where (...) conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.*

*(...)"*.

According to the OECD Transfer Pricing Guidelines, by seeking to adjust profits by reference to the conditions which would have been obtained between independent enterprises for comparable transactions and under comparable circumstances (i.e. in "comparable uncontrolled transactions", if we follow the terminology of such guidelines), the arm's length principle follows the approach of treating the members of an MNE group as entities operating separately rather than as inseparable parts of a single unified business. Because the separate entity approach treats the members of an MNE group as if they were independent entities, attention is focused on the nature of the transactions between those members and on whether the conditions thereof differ from those that would be obtained in comparable uncontrolled transactions<sup>16</sup>.

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<sup>12</sup> Communication from the Commission, *op.cit.*, p. 10.

<sup>13</sup> For more information, see [here](#).

<sup>14</sup> 90/436/EEC Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises – Final Act – Joint Declarations – Unilateral Declarations ([OJ L 225, 20.8.1990, p. 10](#)).

<sup>15</sup> OECD Transfer Pricing Guidelines, paragraphs 1.1 and 1.6.

<sup>16</sup> OECD Transfer Pricing Guidelines, paragraph 1.6.

### 2.1.3. *Associated enterprises*

Article 9 of the OECD Model Tax Convention sets forth the arm's length principle as regards cross-border transactions between "associated enterprises", that is, non-independent parties. An associated enterprise is one satisfying the conditions in Article 9, sub-paragraphs 1a) and 1b) of the OECD Model Tax Convention. Two enterprises are associated if one of the enterprises participates directly or indirectly in the management, control, or capital of the other or if "*the same persons participate directly or indirectly in the management, control, or capital*" of both enterprises (i.e. if both enterprises are under common control)<sup>17</sup>. This is the definition of associated enterprises also used for the purposes of the OECD Transfer Pricing Guidelines<sup>18</sup>.

The analysis in this document takes as its reference transactions between associated enterprises and, therefore, it does not cover the application of transfer pricing rules in scenarios concerning an enterprise and its permanent establishment<sup>19</sup>.

### 2.1.4. *The comparability analysis*

In order to apply the arm's length principle, it is necessary to carry out a comparability analysis<sup>20</sup>, which broadly consists of two key aspects: (i) identifying the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations; and (ii) comparing the conditions and economically relevant circumstances of transactions between associated enterprises (controlled transactions) with those of comparable transactions between independent enterprises (comparable uncontrolled transactions).

As regards the first aspect, several factors (also referred to as "comparability factors") must be taken into account when identifying the circumstances of a controlled transaction<sup>21</sup>: the contractual terms of the transaction, the functional analysis (the functions that each enterprise performs, taking into account assets used and risks assumed), the characteristics of the product or service object of a transaction, the economic circumstances, and the business strategies.

Once the circumstances of the controlled transaction have been established, the actual comparison and assessment of whether the transaction is at arm's length has to take place. For that, it is necessary to identify which magnitude will be the object of comparison (i.e. a transfer pricing method has to be selected); and with what it will be compared (i.e. a potential comparable uncontrolled transaction has to be identified).

In this respect, it must be noted that the assessment of whether prices are at arm's length can be carried out not only by comparing prices of transactions, but also through other

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<sup>17</sup> OECD Transfer Pricing Guidelines, preface (11) and Glossary.

<sup>18</sup> OECD Transfer Pricing Guidelines, Glossary.

<sup>19</sup> Based on Article 7 of the OECD Model Tax Convention.

<sup>20</sup> For more information on the comparability analysis, see OECD Transfer Pricing Guidelines, Section D of Chapter 1 (as amended by the BEPS Report on Actions 8-10), and Chapter III.

<sup>21</sup> OECD Transfer Pricing Guidelines, Section D1 of Chapter I (as amended by the BEPS Report on Actions 8-10).

magnitudes, such as the gross profit level of enterprises. Depending on the characteristics of each case, the most appropriate transfer pricing method must be selected<sup>22</sup>.

The typical process that can be followed when performing a comparability analysis is summarised in the OECD Transfer Pricing Guidelines as follows<sup>23</sup>:

- i. determination of years to be covered;
- ii. broad-based analysis of the taxpayer's circumstances;
- iii. understanding the controlled transaction(s) under examination;
- iv. review of existing internal comparables, if any;
- v. determination of available sources of information on external comparables;
- vi. selection of the most appropriate transfer pricing method;
- vii. identification of potential comparables (comparable uncontrolled transaction) in accordance with the comparability factors set forth at Section D.1 of Chapter I<sup>24</sup>;
- viii. determination of and making comparability adjustments where appropriate; and
- ix. interpretation and use of data collected, and determination of the arm's length remuneration; which allow to conclude on whether the controlled transactions examined are consistent with the arm's length principle.

#### *2.1.5. Transfer pricing adjustments*

Where it is established that a transaction between associated enterprises is not at arm's length, adjustments must be made in order to replicate the conditions of that transaction, had it been carried out between independent parties. It is important to bear in mind that the need to make such adjustments arises irrespective of any contractual obligation by the parties to pay a particular price or of any intention of the parties to minimise or avoid taxation of profits<sup>25</sup>.

Adjustments made to deal with transfer pricing issues, as defined by the OECD Transfer Pricing Guidelines, can be classified into two main categories: (i) those made by a tax administration after the company's tax return is filed, which can comprise primary adjustments, corresponding adjustments, and secondary adjustments; and (ii) those voluntarily made by the taxpayer before the company's tax return is filed, which are known as compensating adjustments.

#### *Adjustments made by a tax administration*

- **Primary adjustments:** *"An adjustment that a tax administration in a first jurisdiction makes to a company's taxable profits as a result of applying the arm's length principle to transactions involving an associated enterprise in a second tax jurisdiction"*<sup>26</sup>.

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<sup>22</sup> Transfer pricing methods are detailed in Chapter II of the OECD Transfer Pricing Guidelines (as amended by the BEPS Report on Actions 8-10) and include: Comparable Uncontrolled Price Method (CUP), Cost Plus Method (CPLM), Resale Price Method (RPM), Cost Plus Method (CPLM), Transactional Net Margin Method (TNMM), and Transactional Profit Split Method (TPSM).

<sup>23</sup> OECD Transfer Pricing Guidelines, paragraph 3.4.

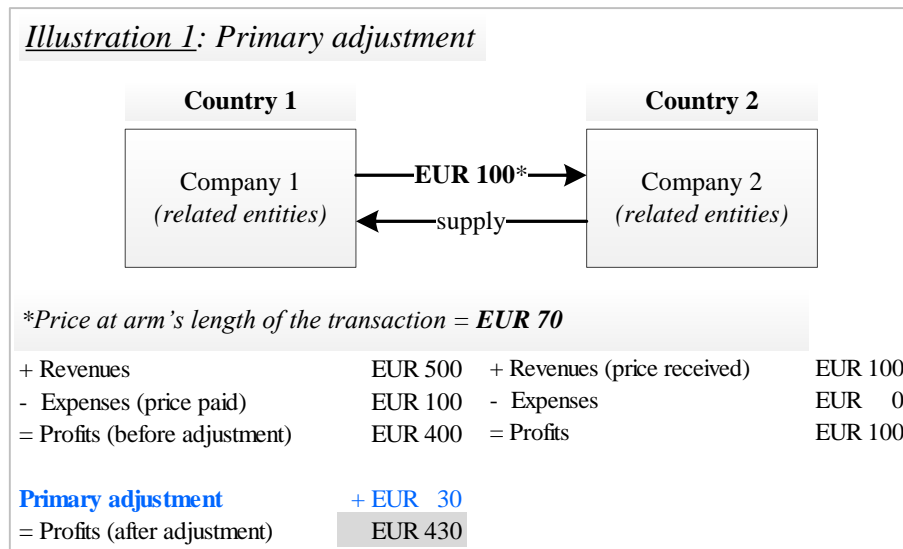
<sup>24</sup> As amended by the BEPS Report on Actions 8-10.

<sup>25</sup> OECD Transfer Pricing Guidelines, paragraph 1.2.

<sup>26</sup> OECD Transfer Pricing Guidelines, Glossary.

So-called "primary adjustments" stem from Article 9(1) of the OECD Model Tax Convention. According to this provision, where there are associated enterprises and conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, *"then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly"*.

Primary adjustments thus concern the modification of the taxable profits of a company, as a result of cross-border transactions with another company of the same MNE group not having been carried out at arm's length. See an example of this below:



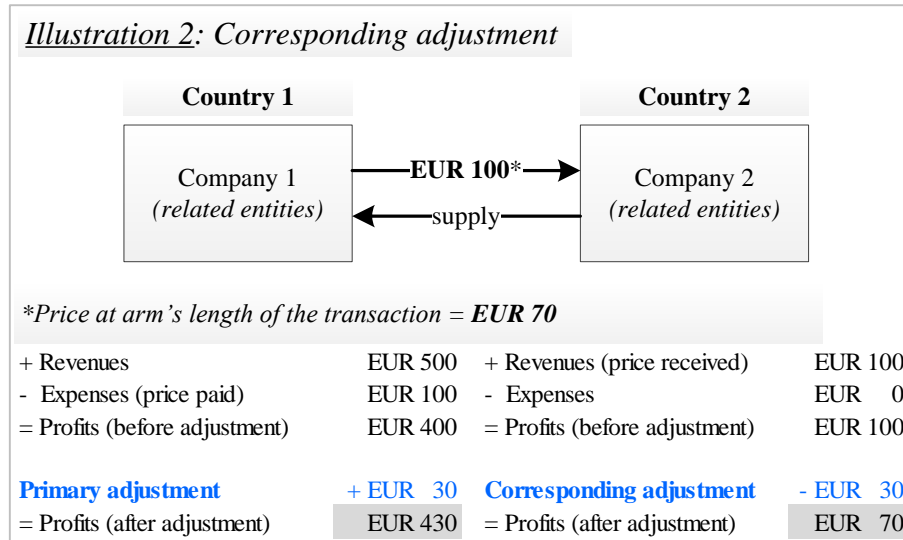
Corresponding adjustments: *"An adjustment to the tax liability of the associated enterprise in a second tax jurisdiction made by the tax administration of that jurisdiction, corresponding to a primary adjustment made by the tax administration in a first tax jurisdiction, so that the allocation of profits by the two jurisdictions is consistent"*<sup>27</sup>.

This adjustment is based on Article 9(2) of the OECD Model Tax Convention: *"Where a Contracting State includes in the profits of an enterprise of that State – and taxes accordingly – profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other"*.

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<sup>27</sup> OECD Transfer Pricing Guidelines, Glossary.

In other words, a corresponding adjustment is that made in response to a primary adjustment, and aims at eliminating any double taxation which may occur as a result of a primary adjustment. If a tax administration increases a company's taxable profits in one tax jurisdiction (by means of a primary adjustment), a corresponding adjustment may be necessary in order to lower the tax liability of that company in the second tax jurisdiction involved<sup>28</sup>. See an example of this below:



Secondary adjustments: "An adjustment that arises from imposing tax on a secondary transaction"<sup>29</sup>. In turn, a secondary transaction is defined as "a constructive transaction that some countries will assert under their domestic legislation after having proposed a primary adjustment in order to make the actual allocation of profits consistent with the primary adjustment. Secondary transactions may take the form of constructive dividends, constructive equity contributions, or constructive loans"<sup>30</sup>.

It is worth noting that the Commentary on paragraph 2 of Article 9 of the OECD Model Tax Convention stresses that it does not deal with secondary adjustments, and thus it neither forbids nor requires tax administrations to make secondary adjustments<sup>31</sup>.

It may be that in some cases a primary transfer pricing adjustment changes the allocation of taxable profits of an MNE group only for tax purposes. As a result of this, after a primary adjustment made under such circumstances there would be a discrepancy between the profits of a company set out for tax purposes ("taxable profits") and the profits registered in its accounts ("accounting profits").

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<sup>28</sup> OECD Transfer Pricing Guidelines, paragraphs 4.32-4.37.

<sup>29</sup> OECD Transfer Pricing Guidelines, Glossary.

<sup>30</sup> *Ibid.*

<sup>31</sup> For more information, see OECD Transfer Pricing Guidelines, paragraphs 4.66-4.76. See also JTPF, [Final Report on Secondary Adjustments](#), 2013; and the consultation document of the HMRC, [Introduction of secondary adjustments into the UK's domestic transfer pricing legislation](#), 2016.



As put forward by some authors, *"A transfer pricing adjustment normally changes only the tax accounts concerned. An actual payment to cover the difference between the payment under the original transaction and the adjusted price (...) has not been made (...) A secondary adjustment accounts for the fact that [the company] has, in reality, not paid the difference"*<sup>32</sup>.

Hence, some countries allow or require follow-up transactions (secondary transactions) in order to make the accounting profits consistent with the outcome of the primary adjustments. For instance, a secondary transaction may consist in the transfer of profits in the form of dividends, constructive equity contributions, or constructive loans, as indicated in the definition above. The nature of this secondary transaction will depend on the characteristics of the case. For instance, *"if the non-payment of the difference is an advantage to a parent company, the amount of the difference is treated as a constructive dividend. An advantage for a subsidiary is treated as an informal capital contribution"*<sup>33</sup>.

A secondary adjustment is the tax consequence arising from such a second transaction (e.g. the payment of a withholding tax on dividends). It is worth noting that the secondary adjustment will be made in the same tax jurisdiction where a primary adjustment has been carried out.

By way of illustration, let us assume two associated enterprises: Company 1 (in Country 1) and Company 2 (in Country 2). As the result of a primary adjustment made in Country 1, more taxable profits (+EUR 30) have been allocated to Company 1, resulting in a total of EUR 430 after the adjustment. This is because the price paid by Company 1 to Company 2 (EUR 100) has been found to be higher than the market price of a comparable transaction (EUR 70) and, therefore, Company 1 has paid an excess of EUR 30.

Although EUR 30 of taxable profits have been allocated to Company 1 for tax purposes, let us imagine that the latter has received no "actual" payment as a result of the primary adjustment (the accounting profits of Company 1 remain EUR 400). As a consequence, there would be a discrepancy between the taxable profits (EUR 430) and the accounting profits (EUR 400) of Company 1.

In order to make the actual allocation of profits as registered in the accounts consistent with the primary adjustment made for tax purposes, the payment made by Company 1 to Company 2 above the arm's length price (+EUR 30), could be treated in Country 1 as a deemed dividend paid to Company 2, for instance (secondary transaction). In consequence, a withholding tax may have to be applied in Country 1 (secondary adjustment)<sup>34</sup>. The reasoning for this is as follows: had the price of the transaction been settled according to the market value from the very beginning, Company 1 would have generated more revenues and, therefore, more profits, which

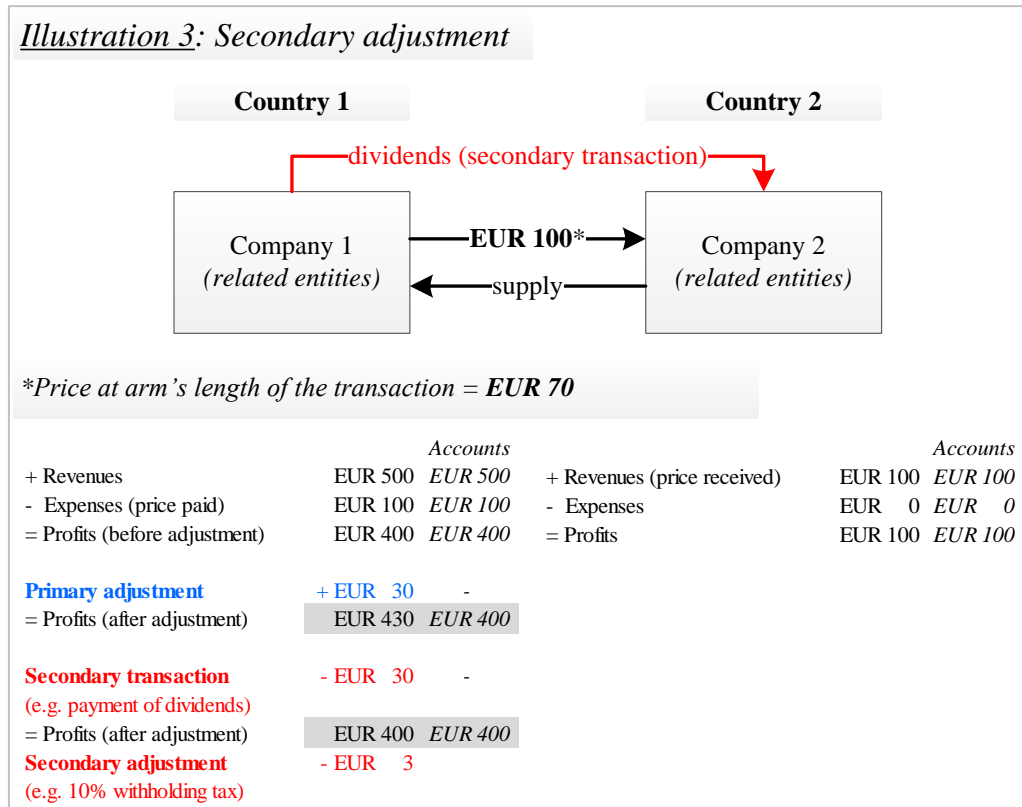
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<sup>32</sup> G. Cottani, *op.cit.*, Chapter 8.

<sup>33</sup> *Ibid.*

<sup>34</sup> See JTPF, *op.cit.*, 2013, paragraph 4: *"Secondary adjustments taking the form of constructive dividends may create double taxation if the other State does not provide a corresponding tax credit or relief under Article 23 of the OECD Model Tax Convention for the withholding tax arising from the secondary adjustment"*.

would have resulted in dividends being paid to Company 2. See an example of this below:



*Adjustments made by the taxpayer*

**Compensating adjustments:** "An adjustment in which the taxpayer reports a transfer price for tax purposes that is, in the taxpayer's opinion, an arm's length price for a controlled transaction, even though this price differs from the amount actually charged between the associated enterprises. This adjustment would be made before the tax return is filed"<sup>35</sup>.

According to the OECD Transfer Pricing Guidelines, compensating adjustments are not recognised by most OECD countries, on the grounds that tax returns should reflect the actual transactions<sup>36</sup>.

Still, compensating adjustments, if permitted or required, allow companies to align their profits with the arm's length principle before submitting a tax return, for instance, in cases where the information about comparable uncontrolled transactions was not available at the moment of setting the conditions (e.g. the price) for transactions with associated enterprises<sup>37</sup> and, therefore, such conditions do not follow the arm's length. Such adjustments could be seen as voluntary anticipation by the taxpayer of a potential primary adjustment made by a tax authority. For instance,

<sup>35</sup> OECD Transfer Pricing Guidelines, Glossary.  
<sup>36</sup> OECD Transfer Pricing Guidelines, paragraph 4.39.  
<sup>37</sup> OECD Transfer Pricing Guidelines, paragraphs 4.38-4.39.

compensating adjustments can be made by adjusting the operating expenses of a company; or by increasing or reducing the transfer price (issuing an additional invoice or credit note in favour of the customer)<sup>38</sup>. This is usually done at the end of the year, before closing the books or when filing the tax return.

At EU level, the JTPF has in one of its reports<sup>39</sup> explored the conditions under which compensating adjustments should be accepted by tax administrations. The conditions are:

- before the relevant transaction or series of transactions, the taxpayer made reasonable efforts to achieve an arm's length outcome; this would normally be described in the transfer pricing documentation of the taxpayer;
- the taxpayer makes the adjustment symmetrically in the accounts in both Member States involved;
- the taxpayer applies the same approach consistently over time;
- the taxpayer makes the adjustment before filing the tax return; and
- the taxpayer is able to explain for what reasons his forecast did not match the result achieved, when it is required by internal legislation in at least one of the Member States involved.

## **2.2. Object of this document**

The purpose of this document is to allow a first exchange of views on whether transfer pricing rules could have VAT implications<sup>40</sup>. Without prejudice to other aspects being raised, it seems that the main aspect which should be looked at is whether transfer pricing adjustments could be seen as consideration given in exchange for a supply.

It falls outside the scope of this document to examine, in particular, the potential VAT implications of the outcome of the BEPS project.

## **3. THE COMMISSION SERVICES' OPINION**

A supply of goods or services is subject to VAT when made for consideration by a taxable person acting as such, pursuant to Article 2(1) of the VAT Directive<sup>41</sup>. In turn, a taxable person is defined as any person carrying out an economic activity, whatever the purpose or results of that activity under Article 9 of the VAT Directive.

Concerning the existence of consideration, from the settled case-law of the Court of Justice of the European Union (CJEU), it is clear that a supply of services is effected for consideration within the meaning of Article 2(1)(c) of the VAT Directive, and hence is

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<sup>38</sup> M.O. Lucas Mas, "Chapter 7 – Value Added Tax in Transfer Pricing and Customs Valuation: Two worlds to tax as one", A.J. Bakker & B.R. Obuoforibo eds., IBFD, 2009, p. 210.

<sup>39</sup> JTPF, [Report on Compensating Adjustments](#), 2014, paragraph 17.

<sup>40</sup> While VAT consequences derived from transfer pricing adjustments will not affect taxable persons for which VAT is neutral (because they charge VAT on their outputs and are able to deduct their input VAT), there could be an impact where one of the parties of a transaction cannot deduct their input VAT (e.g. because the supplies carried out by that party are exempt).

<sup>41</sup> Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ([OJ L 347, 11.12.2006, p. 1](#)).

taxable, only if there is a direct link between the services supplied and the consideration received<sup>42</sup>. Such a direct link is established if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the actual consideration given in return for the service supplied to the recipient<sup>43</sup>.

### **3.1. Taxable amount and the arm's length principle in the VAT Directive**

#### *3.1.1. Supply of goods or services*

Article 73 of the VAT Directive establishes the taxable amount for a supply of goods or services:

*"In respect of the supply of goods or services (...) the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party, including subsidies directly linked to the price of the supply".*

It is not generally required for VAT purposes that the consideration which must be present in order for a transaction to be qualified as taxable, has to reflect the market value of the goods or services supplied. In fact, as to the concept of "consideration", it is settled case-law<sup>44</sup> of the CJEU that the taxable amount for the supply of goods or services is represented by the consideration actually received for them. That consideration is thus the *"subjective value, that is to say, the value actually received, and not a value estimated according to objective criteria"*.

The CJEU has often dealt with cases where the consideration is lower than the cost price of the goods or services supplied. In *Gåsabäck*, where the VAT treatment of food supplied by a hotel to its personnel for a consideration below cost price was examined, the CJEU stated that *"the fact that the price paid for an economic transaction is higher or lower than the cost price is irrelevant to the question whether a transaction is to be regarded as a 'transaction effected for consideration'. The latter concept requires only that there be a direct link between the supply of goods or the provision of services and the consideration actually received by the taxable person..."*<sup>45</sup>. In *Campsia Estaciones de Servicio*, the CJEU confirmed that *"the possibility of classifying a transaction as 'a transaction for consideration' requires only that there be a direct link between the supply of goods or the provision of services and the consideration actually received by the taxable person. Thus, the fact that the price paid for an economic transaction is higher or lower than the cost price (...) is irrelevant as regards that classification"*<sup>46</sup>.

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<sup>42</sup> Amongst others, judgment of 7 October 2010, *Loyalty Management UK and Baxi Group*, C-53/09, EU:C:2010:590, paragraph 51; and judgment of 8 March 1988, *Apple and Pear Development Council*, C-102/86, EU:C:1988:120, paragraph 12.

<sup>43</sup> Amongst others, judgment of 27 March 2014, *Le Rayon d'Or*, C-151/13, EU:C:2014:185, paragraph 29; and judgment of 3 March 1994, *Tolsma*, C-16/93, EU:C:1994:80, paragraph 14.

<sup>44</sup> Amongst others, judgment of 23 November 1988, *Naturally Yours*, C-230/87, EU:C:1988:508 paragraph 16; and judgment of 29 July 2010, *Astra Zeneca*, C-40/09, EU:C:2010:450, paragraph 28.

<sup>45</sup> Judgment of 20 January 2005 *Gåsabäck*, C-412/03, EU:C:2005:47, paragraphs 22 and 36.

<sup>46</sup> Judgment of 9 June 2011, *Campsia Estaciones de Servicio*, C-285/10, EU:C:2011:381, paragraph 25.

In *Weald Leasing Limited* the CJEU regarded "rentals that were set at levels which were unusually low or did not reflect any economic reality"<sup>47</sup> as being potentially contrary to the VAT Directive. However, this case refers to a situation of abusive practice with an artificial low consideration that runs against economic reality, whereas in *Gåsabäck* and *Campsa Estaciones de Servicio* the low consideration was fully justified in economic terms and did not have any abusive purpose.

It may be useful to also refer to the opinion of the Advocate General in *Argos*, which clarified the fact that VAT relies on the subjective valuation of transactions: "...the word 'subjective' is not used here in its normal sense, but rather to describe the value placed by the parties on key elements in a transaction; a meaning which is equally capable of being characterized as 'objective'. The effect of these cases is to distinguish and exclude, for the purpose of assessing the consideration for a sale, any supposed independent valuation, different from that adopted by the parties"<sup>48</sup>.

Still, the VAT Directive does contain in Article 80 an anti-avoidance rule which allows Member States to levy VAT on a transaction based on its open market value rather than the consideration actually paid, provided that certain conditions are met:

*"1. In order to prevent tax evasion or avoidance, Member States may in any of the following cases take measures to ensure that, in respect of the supply of goods or services involving family or other close personal ties, management, ownership, membership, financial or legal ties as defined by the Member State, the taxable amount is to be the open market value:*

- (a) where the consideration is lower than the open market value and the recipient of the supply does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177;*
- (b) where the consideration is lower than the open market value and the supplier does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177 and the supply is subject to an exemption under Articles 132, 135, 136, 371, 375, 376, 377, 378(2), 379(2) or Articles 380 to 390;*
- (c) where the consideration is higher than the open market value and the supplier does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177.*

*(...)"*.

This rule is however applicable only in the case of transactions between persons with close ties, which could be reminiscent of the concept of "associated enterprises" set out for the purposes of the above transfer pricing rules.

In turn, Article 72 of the VAT Directive defines "open market value" as follows:

*"For the purposes of this Directive, 'open market value' shall mean the full amount that, in order to obtain the goods or services in question at that time, a customer at the same*

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<sup>47</sup> Judgment of 22 December 2010, *Weald Leasing Limited*, C-103/09, EU:C:2010:804, paragraph 39.

<sup>48</sup> Opinion of the Advocate General Fennelly of 27 June 1996, *Argos*, C-288/94, EU:C:1996:253, point 21.

*marketing stage at which the supply of goods or services takes place, would have to pay, under conditions of fair competition, to a supplier at arm's length within the territory of the Member State in which the supply is subject to tax.*

(...)"

Although Articles 72 and 80 of the VAT Directive could indeed be seen as reflecting the arm's length principle for VAT purposes, there is one fundamental difference between the scope of application of those provisions and that of the transfer pricing rules: while the arm's length principle must be generally observed in all intra-group transactions under the transfer pricing rules used for the purposes of direct taxation, the scope of the arm's length principle set out under the VAT Directive seems much narrower. In fact, this rule is optional for Member States to apply, and it can only be used in order to prevent tax evasion or avoidance in a set of well-defined circumstances<sup>49</sup>.

Therefore, while the VAT Directive acknowledges the possibility that the price at arm's length may have to be used under certain conditions in order to determine the taxable amount of a supply of goods or services, it is still so that the general rule contained in Article 73 of the VAT Directive provides for the taxable amount to be everything which constitutes consideration, understood as the subjective value actually received.

This has been confirmed by the CJEU in *Balkan and Sea Properties* in which it was made clear that *"by allowing the taxable amount to be taken as the open market value of the transaction in certain cases, Article 80(1) of the VAT Directive lays down an exception to the general rule stated in Article 73 of the Directive, which must as such be interpreted strictly"*<sup>50</sup>.

Also according to the CJEU, the conditions of application that Article 80 of the VAT Directive sets out are exhaustive and, consequently, national legislation cannot on the basis of that provision provide that the taxable amount is to be the open market value of the transaction in cases other than those listed in that provision<sup>51</sup>.

### *3.1.2. Intra-Community acquisition of goods*

According to Article 83 of the VAT Directive, the taxable amount of an intra-Community acquisition of goods is determined in the same way as that of supplies of goods or services:

*"In respect of the intra-Community acquisition of goods, the taxable amount shall be established on the basis of the same factors as are used in accordance with Chapter 1 to determine the taxable amount for the supply of the same goods within the territory of the Member State concerned. In the case of the transactions, to be treated as intra-Community acquisitions of goods, referred to in Articles 21 and 22, the taxable amount shall be the purchase price of the goods or of similar goods or, in the absence of a purchase price, the cost price, determined at the time of the supply".*

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<sup>49</sup> See also I. Rouberol, "Interactions between transfer pricing and VAT adjustments in the European Union", *International VAT Monitor*, September/October 2016, p. 316.

<sup>50</sup> Judgment of 26 April 2012, *Balkan and Sea Properties*, C-621/10, EU:C:2012:248, paragraph 45.

<sup>51</sup> *Balkan and Sea Properties*, paragraph 52.

*3.1.3. Importation of goods*

Article 85 of the VAT Directive establishes the taxable amount for an importation of goods by reference to the corresponding customs value:

*"In respect of the importation of goods, the taxable amount shall be the value for customs purposes, determined in accordance with the Community provisions in force".*

**3.2. Potential impact of transfer pricing rules in terms of VAT: transfer pricing adjustments**

*3.2.1. Need for guidance*

There seems to be a tension between the transfer pricing rules which, based on the arm's length principle seek to arrive at the arm's length valuation of a transaction (i.e. the open market value), and VAT rules, generally based on the consideration being seen as a subjective value (i.e. the price actually paid). Hence, there is a need for some guidance as regards the interaction between these two sets of rules.

Among the issues which could be analysed, some may wonder in particular whether transfer pricing adjustments (upwards or downwards) could have VAT implications. It seems that this could be so where the transfer pricing adjustment could be seen as more or less consideration given in exchange for a taxable supply of goods or services<sup>52</sup> already made (i.e. as an adjustment to a price already paid), leading to a modification of the taxable amount of that transaction for VAT purposes<sup>53</sup>.

In any event, for there to be any VAT implications, the rules as regards the existence of a supply for consideration pursuant to Article 2(1) of the VAT Directive, as interpreted by the CJEU, would have to be met. Notably, there must be a supply made in exchange for consideration, and a direct link has to be established between them. This would have to be assessed on a case-by-case basis.

If an adjustment is found to constitute more or less consideration for a supply of goods or services, this could arguably lead to an increase or decrease in the VAT taxable amount of such transactions, at least where the VAT to be paid is calculated according to Article 73 of the VAT Directive<sup>54</sup>. In that case the taxable amount does not necessarily represent the open market value of the goods or services.

The impact of transfer pricing adjustments on the VAT taxable amount of an importation of goods seems to depend on the prior assessment of whether transfer pricing adjustments can modify the customs value of that importation, given that in such cases, the taxable

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<sup>52</sup> This should also be taken to include intra-Community acquisitions of goods, whose taxable base is also established on the basis of the same factors used for supplies of goods or services.

<sup>53</sup> Another slightly different scenario where VAT implications could arise is that involving a payment triggered by the application of transfer pricing rules (which could be seen as consideration given in exchange for a supply under certain conditions), where there was previously no taxable supply. This scenario has not been covered in particular in the present analysis, although some of the reflections below would still hold.

<sup>54</sup> Focus is not, in this respect, on Articles 72 and 80 of the VAT Directive, which lay down the cases where the taxable amount has to be determined according to the open market value.

amount is based on the customs value pursuant to Article 85 of the VAT Directive. Although this aspect is not for the VAT Committee to assess, some reflections as to the interaction between transfer pricing and customs rules are made.

### 3.2.2. *Initial reflections*

While intending to keep the discussion open, the Commission services still would like to outline various points to be taken into account in the analysis of the question raised:

- Interaction between direct and indirect taxation

It must be stressed that the transfer pricing rules are set out for the purposes of direct taxation, while VAT is an indirect tax. The CJEU has in the past made reference to this distinction, limiting the potential correlation between a direct tax rule and the rules laid down in the VAT Directive.

For instance, in *FCE Bank*, which concerned a transaction between a head office and its branch located in different Member States, it was stated that "*the OECD Convention is irrelevant since it concerns direct taxation whereas VAT is an indirect tax*"<sup>55</sup>. In this respect, the reasoning of the Advocate General, who shares the conclusion of the CJEU, may shed some light on the dichotomy between direct and indirect taxes:

*"Article 7(2) of the OECD model convention provides for the attribution to the permanent establishment of the profits which it might be expected to make if it were 'a distinct and separate enterprise (...) dealing wholly independently with the enterprise of which it is a permanent establishment' (...) The fact that in the field of direct taxation the permanent establishment of a non-resident company is treated as an autonomous enterprise for the purposes of calculating tax on profits should not, I believe, lead to the conclusion that it constitutes an independent enterprise for the purposes of the common VAT system. Firstly, that system is based on concepts, such as that of taxable person, that have been harmonised at Community level and the meaning of which cannot be allowed to vary according to national provisions on the direct taxation of profits without undermining the purpose of the Sixth Directive [present VAT Directive]. Secondly, the 'arm's length' principle enshrined in Article 7(2) of the OECD model convention is based on a legal fiction, since it consists of treating the permanent establishment as if it were an independent enterprise, which it is not. A fundamental criterion of the common VAT system, however, is that it is the actual economic situation that matters. It is as a consequence of this principle, in particular, that the taxable amount for VAT purposes is the value actually received in consideration of the service supplied and not a value determined according to objective criteria. It would therefore be contrary to the system to apply a legal fiction and to treat an internal transaction as if it had taken place between two independent entities"<sup>56</sup>.*

In this respect, however, it must be noted that *FCE Bank* examined transactions between a head office and its permanent establishment, thus making up the same legal person (this was why the Advocate General described them as internal transactions), and not between

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<sup>55</sup> Judgment of 23 March 2006, *FCE Bank*, C-210/04, EU:C:2006:196, paragraph 39.

<sup>56</sup> Opinion of Advocate General Léger of 29 September 2005, *FCE Bank*, C-210/04, EU:C:2005:582, points 62-64.



two associated enterprises which are different legal persons. In fact, the provision of the OECD Model Tax Convention at stake in this case was mainly Article 7(2) (permanent establishments) and not Article 9 (associated enterprises). Hence, some may question whether the findings of the CJEU and the Advocate General apply in scenarios other than that examined in *FCE Bank*.

The CJEU has also stated that tax authorities may not in any circumstances charge an amount exceeding the tax paid by the final consumer<sup>57</sup>. Looking at it from this perspective, transfer pricing rules may be seen as deviating from the subjective value laid down as the tax base for the purposes of VAT.

These reflections should be taken into account when determining the existence of a direct link between a supply and the consideration given in exchange for that supply.

- Existence of the arm's length principle in the VAT Directive

The legislator has already introduced the arm's length principle in the VAT Directive where it seemed relevant, that is, in the scenarios envisaged under Articles 72 and 80 of the VAT Directive. The determination of the taxable amount of a transaction according to the open market value deviates from the general rule laid down in Article 73 of the VAT Directive, which is based on the price actually paid (subjective value).

If all transfer pricing adjustments led to a modification of the VAT taxable amount, the general principle laid down in Article 73 of the VAT Directive could be undermined and the open market value would "de facto" end up becoming the norm. In this respect, the CJEU recalled that the use of the open market value as a taxable amount for VAT purposes is an exception to the general rule, and that the use of such exception is limited to the cases envisaged by Article 80 of the VAT Directive<sup>58</sup>.

This was also pointed out in the past by the Commission, notably in regard to the cost-sharing exemption laid down in Article 132(1)(f) of the VAT Directive.

For instance, the impact assessment of the proposal put forward by the Commission in 2007 as regards the VAT treatment of insurance and financial services<sup>59</sup>, which was

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<sup>57</sup> Judgment of 24 October 1996, *Elida Gibbs*, C-317/94, EU:C:1996:400, paragraph 24. See also judgment of 26 April 2016, joined cases *Balkan and Sea Properties* and *Provadinvest*, C-621/10 and C-129/11, EU:C:2012:248, paragraph 44.

<sup>58</sup> Pursuant to Article 80 of the VAT Directive, and in order to prevent tax evasion or avoidance, Member States may in any of the following cases take measures to ensure that, in respect of the supply of goods or services involving family or other close personal ties, management, ownership, membership, financial or legal ties as defined by the Member State, the taxable amount is to be the open market value: "(a) where the consideration is lower than the open market value and the recipient of the supply does not have a full right of deduction (...); (b) where the consideration is lower than the open market value and the supplier does not have a full right of deduction (...) and the supply is subject to an exemption (...); (c) where the consideration is higher than the open market value and the supplier does not have a full right of deduction (...)".

<sup>59</sup> Commission staff working document – Accompanying document to the Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services ([COM\(2007\) 747](#)) – Impact Assessment ([SEC/2007/1554 final](#)).

recently withdrawn<sup>60</sup>, referred to the tension between transfer pricing rules (requiring an open market mark-up) and the cost-sharing exemption (where one of the requirements for services supplied by the cost-sharing group to be exempt is that they are remunerated at cost). In the proposal, the wording of the condition concerning the reimbursement of cost-sharing services aimed at reconciling this requirement with transfer pricing rules: *"the group claims from its members only the exact reimbursement of their share of the joint expenses, excluding any transfer-pricing adjustments made for the purposes of direct taxation"*<sup>61</sup>.

As regards the cost-sharing exemption, the document produced by the Commission services for the discussion in the 91<sup>st</sup> meeting of the VAT Committee<sup>62</sup>, held in May 2010, also indicated that: *"It is conceivable that the group may become liable for direct tax by virtue of the transfer pricing rules of the Member State in which it is established. In such circumstances the direct tax consequences which may flow from the pricing policy imposed by the VAT Directive should have no impact on the VAT treatment of the services provided by the group"*.

- Existence of consideration

For a transfer pricing adjustment to possibly be seen as more or less consideration given in exchange for a supply, it seems that such adjustment must not only be made for tax purposes, but it has to be reflected in the accounts of the parties to the transaction. In other words, there has to be an actual element which can be identified as extra consideration for the supply already made.

For instance, where as a result of a primary transfer pricing adjustment a transfer of money is made between associated enterprises in order to reflect in their accounts the allocation of profits made for tax purposes, this could be seen as extra consideration for a previous supply, if the payment can be allocated to that specific previous supply and a direct link is found to be present between the two, as shall be examined below.

In that regard the notion of consideration cannot be restricted to that of "payment", but must be taken also to include other forms (e.g. goods or services supplied in exchange for other supplies), as confirmed by the CJEU's settled case-law: *"the consideration for a supply of goods may consist of a supply of services, and so constitute the taxable amount within the meaning of Article 73 of the VAT Directive, provided, however, that there is a direct link between the supply of goods and the supply of services and that the value of those services can be expressed in monetary terms. The same is true if a supply of services is performed in exchange for another supply of services, as long as the same conditions are satisfied. (...) Barter contracts, under which the consideration is by definition in kind,*

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<sup>60</sup> As published in the Official Journal of the European Union ([OJ C 155, 30.4.2016, p. 3](#)).

<sup>61</sup> Article 137b(5) of the Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax, as regards the treatment of insurance and financial services ([COM\(2007\) 747](#)).

<sup>62</sup> Working paper No 654.

*and transactions for which the consideration is in money are, economically and commercially speaking, two identical situations*"<sup>63</sup>.

In *Serebryannay vek*<sup>64</sup>, for example, the CJEU found that obtaining the right to use an apartment in exchange for the supply of services to fit out and furnish that apartment constituted consideration. Also in the pending case *Posnania Investment* the CJEU has been asked whether the transfer of property could constitute a form of payment in the settlement of tax debts, to which the Advocate General concluded that "*the transfer of the benefits in kind ultimately constitutes only a particular form of payment in the context of tax collection. As in a normal tax procedure, the lawfully incurred tax debt is paid, instead of in money, by means of a benefit in kind...*"<sup>65</sup>. *AXA UK*<sup>66</sup> concerned the services of payment collection supplied by a company (Denplan) to dentists, where Denplan collected the payment from the customers, and then transferred that amount (minus a fee) to the dentists. The CJEU found that such deducted fees constituted consideration paid by the dentists for Denplan's services, confirming that consideration can also take the form of amounts set off against each other.

Therefore, based on the existing case-law of the CJEU, it would also seem possible to consider as more or less consideration for a previous supply transactions other than monetary payments (e.g. other supplies of goods or services, or the offsetting of mutual debts between the associated enterprises), provided that such transaction can be allocated to a specific previous supply and that a direct link can be established.

- Existence of supply

A payment, either in money or in kind, would not in itself have VAT consequences as payments do not constitute taxable supplies<sup>67</sup>. For there to be VAT consequences and a payment potentially be seen as consideration, it must be made to another identifiable party in return for a taxable supply of goods or services. So, given that VAT is a transaction-based tax, it must be possible to link that payment to a specific transaction.

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<sup>63</sup> Judgment of 26 September 2013, *Serebryannay vek*, C-283/12, EU:C:2013:599, paragraphs 38-39; and also judgment of 3 July 1997, *Goldsmiths*, C-330/95, EU:C:1997:339, paragraphs 23-25; and judgment of 19 December 2012, *Orfey Balgaria*, C-549/11, EU:C:2012:832, paragraph 35.

<sup>64</sup> *Serebryannay vek*, paragraph 42.

<sup>65</sup> Opinion of Advocate General Kokott of 16 February 2017, *Posnania Investment*, C-36/16, EU:C:2017:134, point 27.

<sup>66</sup> Judgment of 28 October 2010, *AXA UK*, C-175/09, EU:C:2010:646.

<sup>67</sup> Article 135(1)(d) of the VAT Directive exempts transactions concerning payments and transactions concerning currency. Also the Advocate General Kokott, in her opinion of 24 October 2013, *Granton Advertising*, C-461/12, EU:C:2013:700, point 41, indicated that "*payments of money are admittedly not taxed as such but are rather simply the consideration for a taxed supply, either because they are neither a supply of goods nor a supply of services (...) or because they are [exempt]*". This view has been supported by doctrine. For instance, see J. Kajus and B. Terra, "Commentary – A Guide to the Sixth VAT Directive (Historical Archive)", IBCF Tax Research Platform, 2014, Chapter 10: "*the mere use of money as a means of exchange must not give rise to any VAT liability. The aim of this provision is therefore to exempt any dealings in money of account (transferable money), including all operations concerning money transfers and the operations concerning any instrument that facilitates transactions and transfers of money*".

Account taken of this, where transfer pricing adjustments are made on the basis of aggregated amounts, it should be possible to allocate them to individual transactions<sup>68</sup> in order for them to have VAT implications.

- Existence of a direct link between supply and consideration

The possibility of classifying a transfer pricing adjustment as more or less consideration given in respect of a previous supply will also depend on the existence of a direct link between that consideration and the previous supply. Such a direct link is established if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the actual consideration given in return for the service supplied to the recipient<sup>69</sup>.

It was in *Tolsma*, that the existence of a direct link was connected by the CJEU to the existence of a legal relationship between the person receiving consideration for a service and the person paying it, in the sense that there needs to be a reciprocal performance, a service provided in exchange of a remuneration and *vice versa*; *i.e.*, there would be no service for consideration without the remuneration, and the other way round. In this case, where a musician played a barren organ on the public highway and invited passers-by to leave a donation in a tin, it was held that playing music on the public highway for which no consideration was stipulated did not constitute a supply of services effected for consideration.

In the same vein, it seems that the CJEU has dismissed the existence of a direct link in cases<sup>70</sup> where the goods or services supplied could not be foreseen by its recipient, which would imply a lack of reciprocal performance. Hence, some could argue that a variation in the consideration triggered by a transfer pricing adjustment could not be seen as a reciprocal performance in respect of a previous supply, unless agreed by the parties.

Indeed, some authors have suggested that primary adjustments made by tax administrations should not generally entail VAT consequences, since such adjustments do not constitute a form of consideration agreed or contracted between parties but are established by a third party and should instead be seen as an additional cost<sup>71</sup>.

This opinion is usually based on the findings of the CJEU in *Bausystem*, where consideration was found not to cover the interest compensation for late payment

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<sup>68</sup> See R. T. Ainsworth, "Transfer pricing in VAT/GST v direct taxation: part 2", *Tax Planning International Indirect Taxes*, Bloomberg BNA, 2009. The author proposes various ways to solve the allocation problem, such as applying a specific tracing rule (a specific adjustment could be made for the specific transactions the price increase has been proven).

<sup>69</sup> Amongst others, judgment of 27 March 2014, *Le Rayon d'Or*, C-151/13, EU:C:2014:185, paragraph 29; and judgment of 3 March 1994, *Tolsma*, C-16/93, EU:C:1994:80, paragraph 14.

<sup>70</sup> See CJEU, judgment of 8 March 1988 in case 102/86 *Apple & Pear Development Council*, EU:C:1988:120, paragraph 15.

<sup>71</sup> See for instance A. Martins, "VAT Transfer-pricing rules: a Portuguese perspective", *Intertax*, Volume 37, issue 5, Kluwer Law International, 2009, p. 328-329. Note that, according to the author, some VAT implications may arise in certain cases: "*These [transfer pricing] adjustments usually indicate that operations were undervalued, also for VAT purposes. If so, and if one of the parties is not entitled to a full right of deduction, a VAT transfer-pricing adjustment can be due*".

determined by a judge: *"the interest in question in the main action has no connection with the services provided or the receipt of the services and does not constitute the consideration relating to a commercial transaction. On the contrary, it represents simply the reimbursement of expenses, that is to say compensation for the delay in payment (...)* Indeed, the undertaking was compelled to agree to a delay in payment, not provided for in the contract, on the part of the recipient of its services. The interest which constitutes the consideration for that delay was fixed by a court (...) In those circumstances, the grant of credit is only remotely connected to the main services provided. The interest payable in respect of such credit cannot therefore be described as supplementary payment"<sup>72</sup>.

The reasoning above could be said to hold for both adjustments made by tax authorities and voluntary adjustments made by the taxpayer, although there is no consensus in the existing literature<sup>73</sup>.

Two comments must be made in respect of this opinion.

Firstly, it may be questioned that the judgment in *Bausystem* is only based on the fact that the interest had been decided by a third party (the Court). In this respect, it seems that the findings of the CJEU are rather based on the idea that the interests were not linked to the supply of goods or services themselves, but to the late payment of such supply.

And secondly, if the position above was upheld, taxpayers could argue that an adjustment is made because of transfer pricing rules and thus should not have VAT implications, even where the additional price of a transaction actually results from the agreement between the parties (i.e. where the direct link condition would be satisfied). In this respect, contracts and written agreements could be used as evidence of a connection between an adjustment to an initial pricing of a prior supply, where they provide for price adjustment clauses which subject prices to periodic modifications under certain circumstances<sup>74</sup>.

The retroactive adjustment of the taxable amount of a supply already made has also been examined by the CJEU in a series of judgments concerning vouchers, which seem relevant in the case at hand.

For instance, *Elida Gibbs* examined a manufacturer of toiletries issuing money-off vouchers entitling customers to discounts. The manufacturer received the original price (and paid the corresponding output VAT); and later on reimbursed the amount of the discount, and thus claimed a repayment of output tax which it had previously accounted for. The position of the tax administration, which argued that there was no direct link between the sale of the products and the reimbursement, was overridden by the CJEU: *"In*

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<sup>72</sup> Judgment of 1 July 1982, *Bausystem v Finanzamt München für Körperschaften*, C-222/81, EU:C:1982:256, paragraphs 8-11.

<sup>73</sup> For instance, F. Matesanz, "Transfer Pricing Adjustments and VAT", *International VAT Monitor*, September/October 2015, p. 298, argues that primary adjustments should have no VAT impact, while voluntary adjustments could be seen as consideration for VAT purposes. Also E. Santoro, "Transfer Pricing and Value Added Tax in the European Community: Is there room for interaction and, if so, where?", *International Transfer Pricing Journal*, May/June 2007, p. 161-162, argues that *"primary adjustments, together with possible secondary transactions, could not be regarded as further consideration for a previous taxable supply"*, while VAT issues may arise in respect of compensating adjustments made by taxpayers where there is a balancing payment.

<sup>74</sup> M.O. Lucas Mas, *op.cit.*, p. 211.

*circumstances such as those in the main proceedings, the manufacturer, who has refunded the value of the money-off coupon to the retailer or the value of the cash-back coupon to the final consumer, receives, on completion of the transaction, a sum corresponding to the sale price paid by the wholesalers or retailers for his goods, less the value of those coupons. It would not therefore be in conformity with the directive for the taxable amount used to calculate the VAT chargeable to the manufacturer, as a taxable person, to exceed the sum finally received by him. Were that the case, the principle of neutrality of VAT vis-à-vis taxable persons, of whom the manufacturer is one, would not be complied with"*<sup>75</sup>.

The CJEU further confirmed this approach in *Commission v Germany*<sup>76</sup>, where it stated that not adopting the measures necessary to allow adjustment of the taxable amount of the taxable person who had effected reimbursement where money-off coupons are reimbursed contravened the VAT Directive.

Both judgments above would seem to support the need to adjust the taxable amount of a transaction in order to reflect the actual consideration received by the supplier. However, it must also be taken into account that these cases concern adjustments in the consideration derived from the commercial agreements between the parties, which is the aspect which may be said to be missing in respect of certain transfer pricing adjustments.

Finally, reference must be made to the case-law of the CJEU according to which the direct link is said to be broken where the benefits received by the recipient of a supply are unrelated to the consideration paid.

For example, in *Commission v Finland*<sup>77</sup>, where the recipient of the services was obliged to pay an amount according to his financial resources, the existence of a direct link was challenged on the grounds that the amount was not calculated according to the volume of the services received as it was "contaminated" by the client's income and assets being taken into account. Also in *Apple and Pear Development Council* the CJEU found that "*no relationship exists between the level of the benefits which individual growers obtain from the services provided by the Development Council and the amount of the mandatory charges which they are obliged to pay (...) which are imposed by virtue not of a contractual but of a statutory obligation...*"<sup>78</sup>.

In this respect, it could perhaps be argued that a transfer pricing adjustment implying more or less consideration does not necessarily have an impact on the amount of benefits received by the recipient of a supply already made, leading to the conclusion that a direct link may be missing. However, this interpretation may go a step too far, given that transfer pricing adjustments are not completely unrelated to the previous transaction but, indeed, stem from the arm's length valuation of the transaction in particular.

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<sup>75</sup> Judgment of 24 October 1996, *Elida Gibbs*, C-317/94, EU:C:1996:400, paragraph 28.

<sup>76</sup> Judgment of 15 October 2002, *Commission v Germany*, C-427/98, EU:C:2002:581.

<sup>77</sup> Judgment of 29 October 2009, *Commission v Finland*, C-246/08, EU:C:2009:671, paragraphs 49 and 51.

<sup>78</sup> Judgment of 8 March 1988, *Apple and Pear Development Council*, C-102/86, EU:C:1988:120, paragraph 15.

### **3.3. Transfer pricing and customs valuation**

Although the Union Customs Code<sup>79</sup> already reflects the arm's length principle, transfer pricing adjustments can also have an impact on the customs valuation of importations of goods which, in turn, may affect the taxable amount of such transactions as defined in Article 85 of the VAT Directive.

It is not the purpose of this document to analyse the relationship between transfer pricing and customs valuation<sup>80</sup>, but some reflections may be had, particularly having regard to some of the principles which are shared by customs and VAT legislations.

As regards this topic, the OECD Transfer Pricing Guidelines<sup>81</sup> set forth that the arm's length principle is applied, broadly speaking, by many customs administrations as a principle of comparison between the value attributable to goods imported by associated enterprises, which may be affected by the special relationship between them, and the value of similar goods imported by independent enterprises. The guidelines acknowledge that taxpayers may have competing incentives in setting values for customs and tax purposes (in general, a taxpayer importing goods may be interested in setting a low price for the transaction for customs purposes so that the customs duty imposed will be low), and indicate that there could be similar considerations arising with respect to VAT.

### **3.4. Conclusion**

There is a tension between the transfer pricing rules set out for the purposes of direct taxation which, based on the arm's length principle seek to arrive at the arm's length valuation of a transaction (i.e. the open market value), and VAT rules, generally based on the existence of a supply for consideration, where consideration is seen as a subjective value (i.e. the price actually paid).

As regards the interaction between transfer pricing and VAT, transfer pricing adjustments (upwards or downwards) might have VAT implications, for instance, where such an adjustment could be seen as more or less consideration given in exchange for a taxable supply of goods or services already made. If an adjustment is found to constitute more or less consideration for a supply, this could arguably lead to an increase or decrease in the VAT taxable amount of that transaction, where the VAT to be paid has been calculated according to Article 73 of the VAT Directive.

For there to be any VAT implications, though, it is necessary for there not only to be a supply for consideration pursuant to Article 2(1) of the VAT Directive but also for the consideration to be directly linked to that supply. This should be assessed on a case-by-case basis. In order to assess whether the above requirements are met, several aspects should be taken into account:

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<sup>79</sup> See Article 70(3)(d) of the Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code ([OJ L 269, 10.10.2013, p. 1–101](#)).

<sup>80</sup> The pending case C-529/16, *Hamamatsu Photonics Deutschland*, may shed some light on this issue. We also refer to the World Customs Organisation (WCO) [Guide to customs valuation and transfer pricing](#), 2015.

<sup>81</sup> OECD Transfer Pricing Guidelines, Section D5 of Chapter I (as amended by the BEPS Report on Actions 8-10).

- Interaction between direct and indirect taxation

Although the CJEU has never expressly dealt with this issue, it has in the past limited the potential correlation between a direct tax rule and the rules laid down in the VAT Directive.

- Existence of the arm's length principle in the VAT Directive

While the VAT Directive acknowledges the possibility that the price at arm's length may have to be used under certain conditions in order to determine the taxable amount of a supply of goods or services based on the arm's length value, the general rule laid down in Article 73 of the VAT Directive is that the taxable amount is everything which constitutes consideration, understood as the subjective value actually received.

- Existence of consideration

For a transfer pricing adjustment to possibly be seen as more or less consideration given in exchange for a supply, it seems that such adjustment must not only be made for tax purposes, but it has to be reflected in the accounts of the parties to the transaction. In other words, there has to be an actual element which could be identified as extra consideration for the supply already made.

- Existence of supply

A payment, either in money or in kind, could only be seen as consideration where made in return for a taxable supply of goods or services. Therefore, it must be possible to link that payment to a specific transaction. Where transfer pricing adjustments are made on the basis of aggregated amounts, it should be possible to allocate them to individual transactions in order for them to have VAT implications.

- Existence of a direct link between supply and consideration

To fall within the scope of VAT, there must be a direct link between such payment and the goods or services received. According to the CJEU, such a direct link is established if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the actual consideration given in return for the service supplied to the recipient. Based on the existing case-law of the CJEU as regards the existence of a direct link, it is unclear whether transfer pricing adjustments would always meet this requirement.

#### **4. DELEGATIONS' OPINION**

The delegations are requested to give their opinion on the issues raised.

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