

# European Commission's paper on VAT implications of transfer pricing (2/17/17)

On 29 March the European Commission published working paper No. 923 of 28 February 2017 on the possible VAT implications of transfer pricing (TP). The purpose of this document is to allow the first exchange of views on whether the TP rules can have any VAT implications. Without prejudice to other questions being raised, it seems that the main question to be examined is whether TP adjustments can be treated as a consideration given in return for a supply.

The Commission services wish to discuss with the VAT Committee the possible VAT implications of the TP rules laid down for direct taxation purposes. These rules aim to ensure that the terms of transactions within a multinational group (including the price) match comparable market conditions, and that profits are fairly apportioned between the jurisdictions in which the group operates.

To provide legal certainty for businesses and tax administrations alike, it is worth examining whether the TP rules can have any VAT implications for member states.

The OECD and the G20 members have undertaken the Base Erosion and Profit Shifting (BEPS) project, which deals in part with some TP issues. Yet it is outside the scope of the working paper to examine the VAT implications of the outcome of the BEPS project.

The working paper generally describes the basic TP principles. However, the Commission has highlighted a tension between the TP rules for direct taxation purposes, which are based on the arm's length principle, and the VAT rules, which rely on the existence of a supply for a consideration, the latter being seen as a subjective value.

As regards the interaction between TP and VAT, a TP adjustment (upwards or downwards) can have some VAT implications, for instance, where that adjustment can be treated as more or less a consideration given in return for a taxable supply already made. If an adjustment is found to constitute more or less a consideration for a supply, this can arguably lead to an increase or a reduction in the taxable amount of that transaction, with the amount of VAT due calculated under article 73 of the VAT directive.

If we are to see any VAT implications, not only must there be a supply for a consideration under article 2(1) of the VAT directive, but the consideration must be directly linked to that supply. The existence of such a direct link should be assessed on a case-by-case basis. When it comes to meeting these requirements, a number of aspects need to be considered:

- The 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 by the VAT directive.
- The arm's length principle in the VAT directive. While the VAT directive acknowledges that under certain conditions an arm's length principle may have to be used for inferring the taxable amount of a supply from its arm's length price, the general rule laid down by article 73 of the VAT directive provides that the taxable amount is everything that constitutes a consideration, which is taken to mean the subjective value actually received.
- A consideration. If a TP adjustment is to be treated as more or less a consideration given in return

for a supply, that adjustment must be not only made for tax purposes but also recorded in the accounts of the parties to the transaction. In other words, there must be an element capable of being identified as an extra consideration for the supply already made.

- A supply. A payment, whether in money or in kind, can be treated as a consideration only if it is given in return for a taxable supply. That payment must therefore be capable of being linked to a particular transaction. Where TP adjustments are based on aggregated amounts, it must be possible to allocate them to individual transactions if they are to have any VAT implications.
- A direct link between the supply and the consideration. If a payment is to fall within the scope of VAT, it must be directly linked to the goods or services received. According to the CJEU, such a direct link arises from the legal relationship between the supplier and the customer, under which there is reciprocal performance, with the payment received by the supplier constituting the actual consideration given in return for the goods or services supplied to the customer. The CJEU case law relating to the existence of a direct link does not, however, imply that TP adjustments will always meet this requirement.

The delegations are asked to give their opinion on the questions raised in the working paper. We do hope that their opinion will eventually resolve the uncertainties surrounding the VAT implications of TP and minimise the scope for interpretation.