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## **Code of Conduct on transfer pricing documentation in the EU - Frequently Asked Questions**

(see also [IP/05/1403](#))

### **What is transfer pricing?**

Transfer pricing – or inter-company pricing - is a concept applicable to two related parties. It concerns the prices charged between associated enterprises established in different tax jurisdictions for their inter-company transactions, i.e. transfer of goods and services.

### **What is the European Commission proposing in the Code of Conduct?**

The Commission is proposing that Member States would agree to an EU-wide common approach to transfer pricing documentation requirements. The "EU Transfer Pricing Documentation" (EU TPD) would consist of two main elements:

The "masterfile" would contain common standardized information relevant for all EU group members of a multinational enterprise such as a general description of the business and business strategy, a general description of the transactions involving associated enterprises in the EU and the enterprise's transfer pricing policy.

The "country-specific documentation" would consist of a set standardized documentation for each of the specific Member State involved. Each set of country-specific documentation would contain information relevant to that country only such as amounts of transaction flows within that country, contractual terms and the particular transfer pricing methods used.

All Member States involved would have access to the same common documentation and information in the masterfile element, whereas the country-specific documentation would generally be available only to the specific Member State concerned.

### **Why is this EU-wide approach to documentation requirements necessary?**

There is a tendency for Member States to impose increasingly onerous documentation requirements on companies that trade with associated enterprises in other Member States. Globalisation is increasing the number of companies which carry out such cross-border intra-group transactions. Tax administrations must ensure that the prices being charged for the transactions between these associated enterprises are those that would be charged between independent parties, i.e. so-called arm's length prices. They therefore request detailed documentation relating to intra-group transactions in order to obtain sufficient information for the assessment of a multinational's transfer prices.

On the other hand, the existence of different documentation requirements in EU Member States places a heavy burden on companies. The preparation of separate different documentation packages for each of the Member States involved in the transactions is uneconomic. Small and medium-sized enterprises especially can be affected by these problems.

The EU TPD is designed to establish a balance between the tax administrations' right to obtain from a taxpayer the information necessary to assess whether the taxpayer's transfer pricing is at arm's length and the compliance costs for the taxpayer.

### **Would the EU TPD be mandatory for businesses?**

No. The use of the EU TPD should be optional for businesses. However, a company should not arbitrarily opt in and out of the EU TPD approach for its documentation purposes but should retain consistency and continuity in its documentation policy. Therefore, a company that adopts the EU TPD should do so in a way that is consistent throughout the EU and from year to year.

### **Would Member States be obliged to introduce transfer pricing documentation requirements?**

No. A Member State might decide not to impose transfer pricing documentation requirements at all or it might decide to impose documentation requirements which are less detailed than the proposed EU TPD. However, the Code of Conduct proposes that Member States that introduce or amend legal or administrative documentation requirements should take care that their new rules are compatible with the EU TPD approach. This would enable a company to use the same documentation in all Member States.

### **Why is the Commission not proposing a proper instrument of Community law instead of a Code of Conduct?**

The remit of the EU Joint Transfer Pricing Forum is to identify pragmatic, non-legislative solutions to the practical problems posed by transfer pricing practices in the EU. The Code of Conduct is an approach which has regard to the sovereignty of Member States in the direct tax area giving them flexibility as to how to implement it into their domestic law. Such an instrument has already been used in the area of direct taxation and could lead to substantive results. Moreover, transfer pricing is not an area where the Commission has a clear mandate to present more than soft-law initiatives.

### **How would the proposed Code of Conduct be implemented by Member States?**

It is expected that Member States would implement the Code by legislating for it in national law or through administrative guidelines. Until then, companies will have to comply with the national documentation requirements.

### **What is the scope of application of the EU TPD?**

A multinational group of companies that opts for the EU TPD should generally apply this approach collectively to all associated enterprises engaged in inter-company transactions involving enterprises in the EU. The EU TPD should cover transactions (i) between associated enterprises resident in the EU and (ii) between an enterprise resident outside the EU and an associated enterprise resident in the EU. It should not cover transactions between associated enterprises of the same group resident outside of the EU. In other words: at least one of the enterprises must be resident in the EU.

**In what language should the EU TPD be prepared?**

The masterfile should be provided and accepted in a commonly understood language for all the Member States concerned. Translations of the masterfile should be made available only upon specific request. The country-specific documentation should be prepared in a language prescribed by the specific Member State concerned.

**Could tax administrations require additional information and documents going beyond the EU TPD?**

Yes. Each Member State would retain the right to require a taxpayer to provide more information and documents than would be contained in the EU TPD, but only upon specific request or during a tax audit.

**Would the EU TPD also apply to permanent establishments?**

Not as such but its application could be similar. The documentation requirements relating to the attribution of profits to a permanent establishment should be similar to those that apply in cases of transfer pricing between associated enterprises.

**Does the proposed Code of Conduct make any recommendations as regards penalties?**

Yes, The proposed Code recommends Member States not to impose a documentation-related penalty where a taxpayer complies in good faith, in a reasonable manner and within a reasonable time with the EU TPD or with a Member State's domestic documentation requirements and applies its documentation properly to determine arm's length transfer prices.

**Does the proposed Code of Conduct make any recommendations as regards the use of comparable transactions for the purposes of calculating transfer prices?**

Yes. The proposed Code recommends Member States to evaluate domestic or non-domestic comparable transactions, i.e. transactions between independent companies, for the purpose of establishing the arm's length nature of a company's transfer pricing. Regard should be had also to the specific facts and circumstances of the case. For example, Member States' tax administrations should not automatically reject comparables found in pan-European databases asserting that non-domestic markets are not comparable. A taxpayer's use of non-domestic comparables should not, therefore, by itself subject the taxpayer to penalties for non-compliance.

**What sort of documentation requirements exist at present?**

Documentation requirements range from no requirements at all to rather prescriptive requirements. However in the worst situation, a company could have to prepare 25 different sets of documentation which would lead to excessive compliance costs.

**What criteria do Member States use to establish the prices that companies should charge for intra-group transactions?**

Transfer pricing is governed by the OECD principle that transactions must be at arm's length. In other words, trade conditions between two associated companies should not differ from those that would exist between independent enterprises. Under this principle, the effect of special conditions on the levels of profits should be eliminated. Therefore all documentation should demonstrate that the arm's length principle has been respected.

**What subjects will the EU Joint Transfer Pricing Forum discuss in the future?**

The Forum will continue to examine the items listed in its work programme for 2005 and 2006. These include, in particular, alternative dispute avoidance and resolution procedures (including Advance Pricing Agreements and prior consultation) and interest and penalties relating to transfer pricing adjustments.