



## EUROPEAN COMMISSION

DIRECTORATE-GENERAL  
TAXATION AND CUSTOMS UNION  
Direct taxation, Tax Coordination, Economic Analysis and Evaluation  
**Direct Tax Policy and Cooperation**

JTPF/014/2018/EN

Brussels, 26 October 2018

### Summary Record

53<sup>rd</sup> Meeting of the **EU Joint Transfer Pricing Forum (JTPF)** [E00951]  
24 October 2018, Brussels (BE)

#### **1. Introduction, adoption of the agenda and documents adopted under written procedure**

The Chair welcomed the members and informed them that the June 2018 Summary Record (doc. JTPF/010/2018/EN) and the Report on Coordinated Transfer Pricing Audits within the EU (doc. JTPF/013/2018/EN) had been adopted under the written procedure and published on the JTPF webpage. The Agenda (doc. JTPF/011/2018/EN) was adopted.

#### **2. Information by the Secretariat on current ongoing issues**

The Secretariat provided an update on current developments:

- The state of play of the EU List of Non-Cooperative Jurisdictions whereby currently, 6 jurisdictions are listed in Annex I, while 64 jurisdictions feature in Annex II.
- On the “Digital package”, the focus of the Austrian Presidency is on the Digital Services Tax (the interim solution) with the aim to reach political agreement by the end of the year; a number of Council meetings have been scheduled for October and November.
- In the area of VAT, a number of amendments have been adopted in Council, most notably an optional reduced VAT rate for electronic publications.
- The CCTB project has received political impetus in the Council by a recent German-French common position paper following the Meseberg Declaration.
- On the Dispute Resolution Mechanisms Directive, the Commission is preparing an Implementing Regulation on standard Rules of Functioning for the Advisory Commission or Alternative Dispute Resolution Commission as well as on the publicity of the final decisions. In addition, the first meeting of a Fiscalis Project Group on the implementation of Article 10 of the Directive on establishing a Standing Committee for Alternative Dispute Resolution is scheduled for the last week of October. The project group is set to finalise its work in June 2019.
- DG TAXUD is currently finalising a Commission report on automatic exchange of information that will be adopted by the Commission before 1 January 2019. In parallel, DG TAXUD is undertaking an evaluation of the Directive on Administrative Cooperation (DAC).
- The first-ever exchanges of Country-by-Country Reports under the DAC took place within the deadline of June 2018. These exchanges involved Fiscal Years (accounting periods) that started on or after 1 January 2016. The Commission does not have detailed data on the actual exchanges as it can monitor directly only the size of the IT traffic.
- The file on Public Country-by-Country Reporting is still pending before the Council.

- The recent developments in the Fiscal State Aid area include the following: the Commission issuing a “No Aid” Decision in the McDonalds Case (SA.38945); three Decisions to initiate formal investigation procedures: the Madeira Free Zone regional aid scheme (SA.21259), IKEA (SA.46470) and the UK CFC Case (SA.44896); and a Negative Decision with Recovery in the ENGIE Case (SA.44888).

### **3. Discussion on the Draft Paper on "The application of the profit split method within the EU" (doc. JTPF/012/2018/EN)**

The Secretariat presented the Draft Paper on "The application of the profit split method (PSM) within the EU". The document consists of 4 main potential areas of work:

1. When to use the PSM? The Secretariat proposed to work on this area with the aim to better describe the situation in which the PSM should be considered the most appropriate method.
2. How to split the profit? In order to address the uncertainty linked to the choice of the splitting factors, the Secretariat proposed to analyse and better describe the most recurrent splitting factors.
3. Need of simplification. The survey showed that the application of the PSM can in some circumstances be subjective. The Secretariat believes that there is a need to streamline the application of the PSM in order to achieve more certainty, efficiency and fairness.
4. How to simplify the application of the PSM? As a possible way of simplification the paper suggests following the 2-stage approach based on the residual analysis of the OECD Guidance. Under the proposed approach the remuneration of the routine functions (first step) is determined by applying one of the traditional transactional transfer pricing methods. The residual profit (or loss) that remains after having remunerated the routine activities could be allocated (second step) among the parties based upon a formula or predetermined splitting factors.

The two co-chairs summarised the views of the Member States (MSs) and non-governmental members (NGMs) respectively in general terms.

From MSs' perspective, there was broad support for the project but only if the work remain within the scope of the OECD Transfer Pricing Guidelines (TPG). The MS considered the part of the document concerning when to use PSM to be too prescriptive. The way forward was viewed as a 2-stage process where at the first stage, a value chain analysis will help to identify value drivers and on this basis, the splitting factors. At the second stage, the results of the first stage should be taken into account, to decide whether simplification will be feasible according with the arm's length principle. On the other hand, the remaining time for the end of the JTPF's mandate was considered as a constraint on what could be done.

The position of the NGMs was similarly based on a 2-stage process whereby at the first stage further clarification can be given on certain concepts and aspects of the application of the PSM. For instance, the notions of “unique and valuable contributions” and “highly integrated operations” were considered as requiring further clarification. In addition, NGMs pointed out to the usefulness of more detailed examples and potentially of cases where the PSM should not be applied or how it should apply in the case of losses. It was suggested preparing a decision tree on the process of determining in which cases the PSM is the most appropriate method for profit allocation as well as on its subsequent application. The second stage would involve further simplification. In this context, the prospect for using a formula was more controversial.

The summaries of the co-chairs were followed by an exchange of views amongst the JTPF members. The debate can be summarised as follows:

- Concerns by many members on what could be achieved within the limited timeframe by the end of the JTPF mandate in March 2019.
- One NGM expressed the view that the proposed use of the residual analysis was too limiting and one should move away from individual circumstances towards a global formulary apportionment. In addition, the list of splitting factors based on the survey was considered to focus too much on the pre-BEPS circumstances, especially in the context of intangibles.
- One MS emphasized that simplification should be desirable within the EU but questioned whether the JTPF has a mandate to deal with the use of formulary apportionment, as this would move away from the OECD TPG and the ALP. This should be done by means of hard law.
- Another NGM was concerned that further guidance and a drive towards simplification could lead to a disproportionate use of the PSM, whereas the use of one-sided methods was preferable.
- It could be envisaged to create a process map with a (non-prescriptive, non-exhaustive and non-hierarchical) list that matches circumstances and value drivers to splitting factors and discusses the pros and cons of the various splitting factors.
- The splitting factors could be organised by cost-based, asset-based, revenue-based and other factors (e.g. users).
- One NGM suggested that the split be represented by a range (similarly to one-sided methods) and not by a single ratio.
- A splitting factor representing the workforce and its pros and cons was discussed by several members with variations on the scope (only high-ranking employees with significant people functions or all employees).
- The work on identifying splitting factors was seen as a step already in the direction of simplification. However, a number of members saw a detailed discussion of the general need for simplification and specifically, the study of formulae as premature.
- The functional analysis that would be performed in all cases was considered to be a sufficient basis for identifying splitting factors. The nature of the residual profit is that it is derived from the unique way of doing business, so a predetermined formula would not be appropriate. As a parallel, it was recalled that the simplification on low-value adding intra-group services apply to more standardised activities.
- One NGM suggested determining splitting factors based by business model within an industry (reference was made to a relevant study by the University of St. Gallen). Labelling with a specific business model and the business sector would provide a more standardised classification.
- It was also stressed that a possible simplification could be enhanced via cooperative compliance.

All JTPF members were invited to submit their contributions to the paper by end-November. The comments by NGMs may be collected by the acting co-chair to be consolidated in a single document. A subgroup will also be organised. It will convene (mostly by phone conferences) several times until the next meeting in March 2019. A revised version of the draft paper will be circulated to the members by mid-February.

The discussion was followed by two presentations of formulary approaches to allocating profit. The first presentation was given by a MS delegate in his personal capacity and based on his post-doctoral thesis. The ALP was questioned from several perspectives, including the incentive to structure a business for tax reasons and the fact that the methods for profit allocation often disregard how integrated MNEs operate in reality. The increasing importance of intangibles and network effects as well as the reliance on business models that integrate

consumer input were seen as potentially giving rise to more cases of profit splits. A non-standardised application of the PSM could lead to double taxation, which should not be favoured in the internal market. Different approaches in the literature on formulary apportionment were presented, with an emphasis on sales-based formulae. The proposed formulary apportionment was presented as a process whereby the functions are remunerated with a fixed mark-up on costs (i.e. the routine functions with 5% and the non-routine functions with a rate capped at the total profitability), whilst the remaining profits are apportioned on the basis of sales.

The second presentation was by an NGM. The member criticised the ALP as suffering some practical defects and conceptual issues and argued in favour of the benefits of extending and standardising the PSM. He leaned towards the contribution analysis. The proposed splitting factors were borrowed from the CCCTB, i.e. workers, assets and sales. The tax base definition was meant to be borrowed from the CCCTB as well.

The presentations were followed by a discussion on the practical aspects of the proposed approaches, focusing on intangibles (e.g. some marketing intangibles) that might not require continued DEMPE functions to maintain most of their value over time, assets that are not represented on the balance sheet or not represented at their market value.

#### **4. Information by the Secretariat on finalised statistics on Mutual Agreement Procedures (MAP) under the EU Arbitration Convention and APAs in the EU for 2017 (doc. JTPF/007a/2018/EN and JTPF/007b/2018/EN)**

There has been a slight increase in MAP inventory cases in 2017, with 273 cases initiated and 267 cases closed. The total number of pending cases after 2 years rose to 498 at the end of 2017, compared to 435 cases at the end of 2016. A significant number of cases are pending longer than two years in the ‘other category’ – 130 cases, similar figure at the end of 2016 was 109. A significant number of cases are yet to be sent to Arbitration although they have already been pending for 2 years.

The total number of APAs in force has decreased from 1539 at 31.12.2016 to 902 at 31.12.2017 year-on-year; the largest decrease was reported in Luxembourg, due to the expiration of all pre-BEPS APAs following the introduction of BEPS-related changes to Luxembourg domestic law.

#### **5. Any other business**

The Secretariat gave a short presentation of the elements that feature under the Member States’ transfer pricing profiles at the JTPF section on DG TAXUD’s website. The last update was done in January 2014 for most Member States. The Secretariat will send out forms to Member States, so that they update their profiles. The provisional deadline was set at the end of November, with small delays foreseen from some Member States due to the upcoming OECD WP6 meeting.

The Secretariat will also send all members a questionnaire on the future of the JTPF; this is to be filled in by 3 December.

#### **6. Next meeting**

The next and last meeting of the JTPF under this mandate is provisionally scheduled for 7 March 2019. As usual, the pre-meetings will take place the day before.

## **7. List of participants**

From the Member States, Belgium and Cyprus were not present. From the Non-Governmental Members, the representatives of A.P. Moller Maersk and AB Volvo were absent. The OECD was represented at the meeting. The EP and the UN were not represented.

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