Technology Industries of Finland

3 January 2024

**Technology Industries of Finland’s submission to the public consultation:
Proposal for a Council Directive on Transfer Pricing**

European Commission (EC) has requested comments regarding the Transfer Pricing directive proposal COM (2023) 529 final (“TP directive”). According to the European Commission the purpose of the BEFIT directive proposal package (including BEFIT, TP and HOT initiatives) is to make it easier for companies to do business in the EU’s internal market, ease the heavy tax administrative burden and reduce compliance costs. This could also boost the competitiveness of the EU’s single market and lift barriers to cross-border operations, as well as decrease the risk of double taxation and costly disputes.

According to the EC, the purpose of the transfer pricing directive proposal is to harmonize the transfer pricing rules applicable in the EU, to clarify the position of the OECD's transfer pricing guidelines, and at the same time to create EU specific definitions to e.g. the arm's length principle.

Technology Industries of Finland (TIF) welcomes the opportunity to comment the TP initiative.

- We agree with the Commission that tax compliance is currently too burdensome and complex. Thus, we welcome ideas to ease up the administrative burden of business. However, when introducing new administrative models, it should be thoroughly analysed whether the administrative burden will factually turn less burdensome, or just generate an extra layer of compliance. **TIF does not believe the TP directive (together with the BEFIT directive) would ease the complexity and burden of tax compliance, but in fact increase it.**

- The European Commission's goal with the TP directive proposal seems to be to cover the entire thousand pages wide OECD TP regulation in a few dozen pages. The OECD has comprehensive transfer pricing guidelines and their extensive, constantly updated commentary. The guidelines are widely applied around the world, and although they are not simple, they are well established. **The current transfer pricing rules and arm’s length principle should be kept in force and prioritized.**

- EC’s goal is to unify the interpretation of the OECD's transfer pricing guidelines. **This should not be done by creating parallel EU definitions deviating from the OECD transfer pricing model rules and related guidelines**, such as the arm's length principle.

- If the EU wants to unify the application of the OECD's transfer pricing guidelines, it should rather be reached by supporting the EU Member States to implement the OECD's regulation into their own national legislation as a statutory source of law.

1 TP directive (together with BEFIT) will increase complexity and administrative burden

- The TP directive proposal introduces yet another overlapping reporting obligation (TP directive proposal pg. 17 and 22).

- All tax regulation changes cause expensive alterations to companies' systems and have unpredictable effects. Therefore, an international approach (OECD) is the only reasonable

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option. The cumulative effect of OECD, EU and national corporate tax regulation would be unreasonably heavy.

- **The timing of the BEFIT package including the TP directive is poor. There needs to be a legislative break to give time for companies and tax administrations to implement the minimum tax legislation.**

- Transfer pricing rules and other tax regulation with countries outside of the EU will remain unchanged. For multinational companies doing business outside the EU, TP directive would cause an extra layer of administrative work and costs, interpretation problems and expensive tax disputes.

- An EU specific definition of the arm’s length principle would cause enormous interpretation problems and double taxation. **There is also no guarantee that non-EU countries would accept the result defined by the EU's arm’s length principle.** It is unclear what would happen in practice, if a non-EU country would disagree with the arm’s length level defined by the EU rules.

- Companies fear that there will be no predictability in the allocation of taxable income, if the new BEFIT formula, different from OECD TP rules, is introduced. In this case, the taxable income could be allocated to a country that does not have the funds to pay the tax. This unpredictability would cause a possible obstacle to grow cross-border in EU.

2 How immaterial rights’ and R&D investments’ justified impact to value creation would be ensured?

An essential principle of fair taxation is to ensure that the company pays taxes where its value is created. TIF supports this established principle, also supported by the OECD’s transfer pricing rules. The consumer's location cannot be a key value creator. The research and development of the product or service and the related immaterial rights must have more impact to value creation. The anticipated BEFIT formula would allocate more taxing rights to the country where the product or service is purchased or consumed. A distribution formula that does not take into account intangible assets and R&D would not encourage Member States to invest in digitalisation, sustainable growth and new green technologies, research and development.

Also, in the Finnish government program it is mentioned that:

> When distributing taxation rights and revenues internationally, the principal rule should remain to be that emphasis is given to value creation, innovation, research and development activities (unofficial translation).

3 BEFIT- and TP directives could lead to tax revenues eloping outside of the EU

TIF is concerned that a possible BEFIT distribution formula and EU TP directive would reduce group companies' taxable income in the EU. Already now, in group companies located outside of the EU e.g. China and India, the principles of distribution of taxable income based on transfer pricing rules are being questioned. Currently, the taxable result has been allocated based on the value creation rules of the OECD TP guidelines. If within the EU more value is given to the location of staff, final destination of sale and the location of tangible assets, tax revenues could be allocated outside the

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EU (if the not yet published BEFIT allocation formula would resemble the old CCCTB and the January 2023 BEFIT public consultation proposal). For example, if the number of personnel in a group company located in an EU Member State is 100 and in China 1,000, according to the anticipated BEFIT distribution formula, it would be justified to allocate more taxing rights to China, regardless of the added value created by the R&D work in the EU.

So far, the European parent companies have been able to prove that according to the OECD's transfer pricing guidelines and correct application of the arm's length principle the allocation has been made correctly and equitably. The profit has been taxed where the value has been created. If EU legislation changes these rules, more taxable income will undoubtedly be allocated outside of the EU.

4 Detailed comments on the TP directive text

In addition, TIF would like to point out the following more detailed issues, which show that **the TP directive proposal deviates from the OECD's TP guidelines and will cause interpretation problems**:

- On page 16 of the BEFIT directive proposal regarding the Article 51 traffic light model (risk analysis):
    - "Member State tax administrations would be expected to focus their efforts to the high-risk zones". From a Finnish point of view, it is difficult to believe that Member States would not have more advanced risk analyzes for target selection than the presented traffic light structure.
    - The traffic light model does not ease administrative burden. A company has to, in any case, go through an EU comparative analysis ("benchmark") with its distributor and contract manufacturer globally in order to know their risk status.
    - Also, OECD’s Amount B seems to overlap with this model, regarding distributors and contract manufacturers. How would EU TP regulation deal with possible conflicting results with the Amount B model?
    - In addition, in the EU model, with regard to contract manufacturers, the model seems to apply only to "contract manufacturer" type activities, but not to "toll manufacturer".

- Pg 14: ”This proposal does not advocate any preference for any of the above listed recognised transfer pricing method.” OECD TP guidelines has a preference on the CUP method.
- Pg 14: ”Economic valuation technique” seems to be a new EU spesific method, not mentioned in the OECD TP guidelines.
- Pg. 14: In the directive proposal, there is a long list of applicable transactions to CUP method, whereas in the OECD TP guidelines, there are preconditions (e.g. 2.18-2.20).
- Pg 15: ”sold by a manufacturer”. Cost plus method seems to be recommended without a more detailed analysis of the manufacturers’ actual functions.
- Pg 17: ”In some cases, application of a pricing method will produce a single result that is the most reliable measure of an arm’s length result”. Compared to the OECD TP guidelines, this seems quite a slight rule: basing arm’s length level on a single comparison result, regardless of the method used.
- Pg 17 and Article 12: ”The interquartile range is the range from the 25th to the 75th percentile of the results..” There is no such rule in the OECD TP guidelines, but (3.62): “it may be appropriate to use measures of central tendency to determine this point (for instance

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the median, the mean or weighted averages, etc. depending on the specific characteristics of the data set), in order to minimize the risk of error due to unknown or unquantifiable remaining comparability defects."

- Pg 18 (1): Does the word "entity" refer to a company or a legal entity (e.g. profit center)?
- Article 6: "Corresponding adjustment" Such possibility is already available in tax treaties, the arbitration convention and the dispute resolution directive. This seems like an overlapping process, with its own administrative burden. Also, it remains unclear how this interacts with MAP applications.
- Article 8: "Economically relevant characteristics". Is this comparable to OECD TP guidelines 1.34?
- Article 11(4): "Member States shall ensure that the search for comparable uncontrolled transactions is transparent and reproducible". The meaning of the sentence is unclear.
- Article 12 (3): "Member States shall ensure that a taxpayer is not subject to adjustment if its results fall within the arm's length range, unless it is proven that a specific different positioning in the range is justified by the facts and circumstances of the specific case". In the OECD TP guidelines (3.60) adjustment will not be made if the result is within the arm's length range.
- **Article 13: TIF suggests that the whole "Transfer pricing documentation" Article is removed.**

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Technology Industries of Finland (TIF) represents Finnish technology industries and has over 1,800 member companies, sizes varying from small SMEs and start-ups to world leading MNEs. The technology industry is comprised of five sub-sectors: electronics and the electrotechnical industry, mechanical engineering, metals industry, consulting engineering and information technology. Technology industry is the most important export industry in Finland, with operations constituting over 50 % of all Finnish exports and responsible for 65 % of all private investments in R&D carried out in Finland. Over 350,000 Finns work in technology companies, while a total of around 700,000 people work in the technology sector directly or indirectly (of a total population of 5,500,000).[1]

[1] For further information of TIF's member companies, please see https://teknologiateollisuus.fi/en