

Transfer Pricing Forum

Transfer Pricing for the International Practitioner

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Legislation

The Belgian tax authorities published the final Transfer Pricing Circular on February 25, 2020 – over a year after the initial public discussion draft was published in November 2018. This final Circular had been highly anticipated, after two revised versions had been published in June and November 2019 respectively.

Broadly, the Transfer Pricing Circular aligns the Belgian transfer pricing guidance with the OECD Transfer Pricing Guidelines. For instance, the application of the simplified approach on the pricing of low value-adding services (allowing the application of a 5 percent net cost-plus mark-up) is formally prescribed and applied by the Belgian tax authorities in this Circular. The Belgian tax authorities are also expected to apply the OECD principles on Hard-to-Value-Intangibles, considering *ex-post* outcomes as presumptive evidence of the appropriateness of *ex-ante* pricing arrangements, in line with observations of the positions taken by transfer pricing inspectors in audits even prior to the publication of this Circular.

The same may be said of the guidance on business restructurings, where the Transfer Pricing Circular sets out the OECD's two-part guidance into a four-step process for the analysis of the restructuring, followed by guidance on the transfer pricing to be applied post-restructuring. The four-step process to determine the arm's length compensation for the restructuring itself is as follows:

- Step 1: Analysis of the transactions included in the restructuring;
- Step 2: Recognition of the restructuring;
- Step 3: Examining the relationship between the restructuring and the shift-of-profit potential;
- Step 4: Examination of the transfer pricing consequences of the restructuring.

Based on this guidance, the Belgian tax authorities have set out an expectation that a study and analysis of the business restructuring should be prepared, to demonstrate a "*definite answer*" as to whether something of value from the restructured party has been transferred to a related party, and the appropriate value of such transfer. Specifically, the Belgian tax authorities have provided an example in the Circular, which sets out their expectations that a limited risk Belgian taxpayer (e.g., a toll manufacturer or limited risk distributor) should recharge any exceptional costs (without a mark-up) arising from a restructuring to the principal, the party making the decisions behind the restructuring, or the beneficiaries of the restructuring. While in line with OECD guidance, this further emphasizes the expectations from a Belgian standpoint as to how restructuring costs should be handled – in line with observations from transfer pricing audits prior to the publication of this Circular.

The Transfer Pricing Circular also sets out guidance on performing comparability analyses, adopting the nine-step process as prescribed by the OECD Guidelines. The Belgian tax authorities have also confirmed through the Circular their expectation about the frequency of performing new comparability analyses, which are to be performed every three years, with financial updates to be performed for the years in-between. In addition to the guidance that aligns the Belgian tax authorities' approach with the OECD guidance, a few Belgian specific viewpoints have also been set out, including the following:

- The comparable data used in an analysis should contain at least three years of data, results of which should be used to test the single-year results of the tested party. In other words, the Belgian tax authorities do not generally adopt an approach of term testing (i.e., assessing the results of the tested party over a multi-year period) for transfer pricing documentation purposes;¹
- Loss-making companies with two or more years of losses should not be included in the comparable set when performing an analysis for testing the results of limited-risk entities;
- Considering the potential incomparability of start-up companies, the Belgian tax authorities have specified that companies that have been operating for less than four years should be excluded from the comparable set; and
- The Belgian tax authorities specify that the interquartile range is preferred when assessing the arm's length nature of a tested party's returns. In the event that the tested party's result falls out of the range (i.e., the interquartile range, and in certain cases the full range only if the full comparable set can be demonstrated to be highly comparable), an adjustment would be made towards the range - with the potential for an adjustment towards the median in the absence of rationale to apply other points within the range.

The Transfer Pricing Circular also sets out guidance on intercompany financing transactions, drawing from the OECD's Transfer Pricing Guidance on Financial Transactions published in February 2020. In the Transfer Pricing Circular, certain specific positions of the Belgian tax authorities have been set out, including the following:

- Notwithstanding the determination of a rating per company, under a cash pooling arrangement, the Belgian tax authorities are of the opinion that it can reasonably be assumed that all participants in the cash pool provide cross-guarantees to each other and hence, all participants in the cash pool are considered to have the same credit rating;
- Unless otherwise demonstrated, under a cash pooling arrangement, the cash pool leader is expected to be providing a service to the cash pool and should receive an arm's length remuneration for this service. Generally, this fee may be determined based on a cost-based method;
- The Belgian tax authorities believe that the compensation for the cash pool participants is best determined by an interest rate that is more favorable than the interest rate they would have been able to obtain from a bank on a stand-alone basis;

¹ The testing approach may deviate from the single-year testing approach under certain circumstances such as in an APA, or considering the transfer pricing implications of Covid-19 (based on the OECD guidance published on December 18, 2020).

- The Belgian tax authorities are of the opinion that if, during a period of 12 months, the same participant in the cash pool holds a stable or same positive or negative position throughout the period, that participant's position for the period would be reclassified as a short-term loan or borrowing; and
- If a group member provides an explicit guarantee to another group member (the borrower) and this explicit guarantee enables the borrower to obtain a loan at better conditions, compensation through a guarantee fee should be considered. In determining the compensation for the guarantee, the Belgian tax authorities prefer the so-called yield approach. A comparison is made between the interest that a company should pay with and without the warranty. This should also consider the fact that for any 'implicit' guarantee, no compensation should be paid.

Cases and Rulings

Transfer pricing rulings continue to be an avenue for Belgian taxpayers to gain certainty on their transfer pricing matters - whether on a unilateral, bilateral, or multilateral basis.

Presumably due to the high volume of ruling requests in Belgium, in October 2020, the Belgian ruling commission issued a notice regarding the timely submissions of pre-filing applications or ruling requests. This notice specified that pre-filing and ruling requests should be filed by January 31, 2021, in order to enable the Belgian ruling commission to deliver a decision before the corporate tax return filing deadline at the end of September 2021. It is expected that a similar timeline for future ruling requests will apply (i.e., pre-filing and ruling requests to be filed by the end of January following the financial year to be covered by the ruling). All requests should contain the key information including (i) description of the taxpayer / company; (ii) activities performed; (iii) purpose of the request; and (iv) description of the methodologies proposed and the supporting analysis / calculations. The general rule of thumb, as explicitly mentioned in this notice, is that pre-filing and ruling requests are to be submitted at least eight months before the corporate tax return deadline.

Innovation income deduction rulings remained highly pursued, accounting for approximately 10 percent of the total ruling requests in Belgium in 2019. Rulings related to restructurings were similarly comparatively high in number, accounting for 11 percent of the total ruling requests. Other transfer pricing related rulings accounted for about 5 percent of the total ruling requests in the same year.² In general, the ruling commission continues to be detailed in the approach, requiring details on the transactions and approaches proposed, but yet remaining reasonable in negotiating positions taken.

It should be noted that rulings concluded in Belgium are subject to the European Commission's mandatory exchange between the respective EU tax authorities of countries in which parties to the transaction are present. Such cross-border rulings are submitted to a central depository, where information such as the (i) identification of the taxpayer and group, (ii) content of the ruling or Advance Pricing Arrangement ("APA"), (iii) criteria used for determining the transfer prices, and (iv) identification of the Member States affected by the APA / ruling, are reported. Belgium is also subject to the BEPS Action 5 minimum standard on the compulsory spontaneous exchange of information on tax rulings. Under this framework, tax administrations of the respective jurisdictions may expect to be provided with timely information on rulings that have been

² Dienst Voorafgaande Beslissingen in Fiscale Zaken, Jaarverslag 2019 (2019 Annual Report for the Ruling Commission in Fiscal Matters).

granted to a foreign related party of their resident taxpayer, which may then be used in conducting risk assessments. Based on the OECD's 2019 Peer Review Reports on the Exchange of Information on Tax Rulings, peer input with respect to the exchanges of information on rulings received from Belgium has been positive, indicating that the exchange of information has been "complete, in a correct format, and almost all received in a timely manner".³

Transfer Pricing Documentation

In line with the guidance provided by the OECD under BEPS Action 13, Belgium introduced transfer pricing documentation requirements through the Program Law of July 1, 2016 and the related Royal Decree dated October 28, 2016. Consequently, Belgium now has a formal transfer pricing documentation obligation which requires the electronic filing of such documentation.

The transfer pricing documentation structure proposed by the OECD has been adopted by Belgium, i.e., the three layers of documentation:

- Country-by-Country Report ("CBCR");
- Master File; and
- Local File.

Taken together, these three documents oblige taxpayers to articulate constituent transfer pricing positions. As a recap, the following are the transfer pricing documentation requirements, which have been applied as from the financial year ended 2016 onwards:

Transfer Pricing Documentation Requirement	Threshold / Requirement	Deadline
CBCR	<ul style="list-style-type: none"> – Groups with a consolidated gross revenue exceeding EUR 750 million (based on the financials of the preceding financial year) will need to file the CBCR. Only the ultimate parent (or where applicable, the surrogate parent entity), will have to perform the filing. – For a Belgian constituent entity that is not the filing entity, a <i>CBCR notification</i> will need to be filed. 	<ul style="list-style-type: none"> – CBCR - Due 12 months after the Group's financial year end. – CBCR notification - by the end of the Group's reporting period. For financial periods ended on or after December 31, 2019, Belgian constituent entities of a multinational group will no longer be required to file the CBCR notification annually, provided that the information already filed in previous CBCR notifications remains the same.

³ OECD (2020), Harmful Tax Practices - 2019 Peer Review Reports on the Exchange of Information on Tax Rulings: Inclusive Framework on BEPS: Action 5.

Transfer Pricing Documentation Requirement	Threshold / Requirement	Deadline
Master File form	<p>Required for Belgian companies or permanent establishments that exceed one of the following thresholds (based on the preceding year's financials):</p> <ul style="list-style-type: none"> a) A sum of operational and financial income of EUR 50 million (excluding non-recurring income); b) A balance sheet total of EUR 1 billion; or <p>An annual average of employees of 100 full-time equivalents.</p>	Due 12 months after the group's financial year end.
Local File form	<p>Same thresholds for the Master File form apply.</p> <p>Part 2 of the Local File form is only required if there are business units of the Belgian taxpayer that have more than EUR 1 million of cross-border intercompany transactions in a given year.</p>	Due at the time of the corporate income tax return filing.

Clarifications on the Belgian Transfer Pricing Filings

At the end of June 2020, the Belgian tax authorities published an additional transfer pricing circular setting out a list of Frequently Asked Questions (“FAQs”) and clarifying various aspects of the transfer pricing filings.

One of the key aspects of the FAQs to note is the Belgian tax authorities’ expectation that a transfer pricing study, including a comparability and functional analysis in line with OECD’s Action 13 requirements, is prepared at the time of filing the Local File form (under Section B10). Prior to the publication of this list of FAQs, some taxpayers had interpreted the term “transfer pricing study” to be just the availability of comparability or benchmarking studies. This is an aspect that taxpayers should certainly review when completing the annual Local File form and assess whether this requirement has been met.

The FAQs also clarify the following aspects, among others:

- As it had already been clarified prior to the June 2020 circular, the circular reiterates that the EUR 25,000 threshold for reporting cross-border related-party transactions was only relevant for non-core transactions: core or recurring transactions that fall below this threshold still need to be reported;
- It is interesting to highlight that, for intercompany financing transactions, only the interest amounts are considered when assessing the filing threshold of EUR 1 million cross-border transactions, which determines whether a taxpayer is obliged to file Part II of the Local File form (i.e., requiring the actual reporting of the cross-border controlled transactions). This means that there could be certain taxpayers that may not meet the threshold for filing Part II of the form if their key cross-border controlled transactions only pertain to intercompany financing transactions and low interest rates have been applied;
- The Belgian tax authorities also reiterated that for Belgian permanent establishments (“PEs”) of foreign head offices, only the financial and headcount information of the Belgian PE will need to be considered when assessing the thresholds as to whether the transfer pricing compliance requirements have been met. Conversely, for foreign PEs of Belgian head offices, the full legal entity (including the PE) are considered and the transactions of the foreign PE (e.g., between the foreign PE and other related parties) will also need to be reported in the Local File form in Belgium;
- The FAQs clarify that various transactions under a certain category (e.g., sale of goods) will need to be summed up and reported in a single line or amount if they belong to the same business unit. This confirms that the purpose of the Local File form is to help the Belgian tax authorities to assess the transfer pricing risk of a taxpayer and not necessarily to assess the specific transactional details. Aspects of the Local File form are assessed (by a data mining tool) to help the tax authorities to identify potential transfer pricing audit targets; and
- The transfer pricing methods that can be reported are strictly limited to one of the five OECD prescribed methods. While paragraph 2.9 of the OECD Guidelines indicates that groups are free to apply methods other than the OECD prescribed methods, this is not an option in the Local File form in Belgium.

Transfer Pricing Examinations/Audits

Responsible Teams for Conducting Audits

While transfer pricing audits are primarily driven by the Special Transfer Pricing Audit Division, the number of inspectors at the Belgian tax authorities conducting transfer pricing audits has grown. This is due to the enhanced cooperation between the Special Transfer Pricing Audit Division and the Large Companies Department, where members of the Large Companies Department have been trained in transfer pricing, with an expectation of performing thorough transfer pricing and international tax audits on assigned multinational entities operating in Belgium. In addition, the Special Investigation Squad (*Bijzondere Belastinginspectie - BBI/Inspection Spéciale des Impôts - ISI*) has also concluded a protocol with the Special Transfer Pricing Audit Division, whereby BBI/ISI will also focus more on transfer pricing issues by coordinating and liaising with the Special Transfer Pricing Audit Division.

Issuance of Requests for Information

At the beginning of each year, the Special Transfer Pricing Audit Division tends to send out its standard transfer pricing questionnaire / request for information to a few hundred Belgian taxpayers who are part of multinational enterprises. As mentioned, the Special Transfer Pricing Audit Division has started the process in mid-January 2021, initiating transfer pricing audits for the year.

Such standard transfer pricing questionnaires normally contain a list of more than 30 general questions which require information on the company's overall business activities, intra-group transactions, functions, risks and assets, as well as existing transfer pricing policies and studies. In addition to the standard questions, some specific questions may be added by the particular tax inspector based on available information (e.g., information available through transfer pricing disclosure forms filed). For certain larger multinational entities, specially designed questionnaires / requests for information have also been used by the Special Transfer Pricing Audit Division. In general, responses to these questionnaires will need to be provided within 30 days upon receipt. Incomplete or delayed responses can result in an *ex-officio* tax assessment. As mentioned earlier, upon the request of the company, there may also be a pre-audit meeting arranged with the inspector. Should a taxpayer opt for such a pre-audit meeting, the tax authorities will need to be informed of the request within 10 days upon receipt of the questionnaire.

Audit Triggers

Transfer pricing audits are oftentimes triggered through the data mining performed by the Belgian tax authorities on the transfer pricing filings (i.e., Master File form, Local File form, CBCR). For instance, companies that have indicated in their Local File Forms that they have undergone business restructurings, or that they have no transfer pricing studies (i.e., documentation in line with the OECD's Action 13 requirements) may be identified for a transfer pricing audit. Furthermore, as the Local File Form requires a disclosure of the last three years' financial results, this makes it easy for the Belgian tax authorities to identify companies that have experienced fluctuations in their operating results, making these companies more susceptible to a transfer pricing audit. Needless to say, important inconsistencies and differences between information filed through the forms between years may also be an audit trigger for the Belgian tax authorities. Other potential transfer pricing audit triggers include transfers of (intangible) assets, large interest payments and cash pool positions, transactions with tax havens, etc. The accurate delineation of transactions, procurement arrangements, transactions pertaining to intangibles (and particularly hard-to-value intangibles), or captive arrangements may receive particular attention during a transfer pricing audit.

In addition, taxpayers who have not complied with the filing requirements (e.g., non-filing or incomplete/incorrect filings) may also be selected for a transfer pricing audit. Especially, as from early February 2021, such taxpayers have received more tailored requests for information announcing a transfer pricing audit.

Following the three-tiered approach to transfer pricing documentation, it is expected that a considerable number of multinational enterprises will undergo a thorough transfer pricing and international tax audit in the coming years (in particular, with respect to Anti-Tax Avoidance Directive related topics).

Recent Observations

It has been observed that the transfer pricing audits as driven by the requests for information / questionnaires sent out in January 2021, have generally not taken a more customized approach despite the amount of information already received by the Belgian tax authorities through the transfer pricing filings. Most of the questionnaires continue to be standard. As stated before, the questionnaires sent out in February 2021 are more tailored, perhaps due to the datamining approach taken to identify transfer pricing audit targets. It has also been observed that Belgian taxpayers that have an ongoing APA procedure may also be selected for an audit for the years covered under the APA. In such cases, it is recommended to highlight the ongoing APA process upfront to the designated transfer pricing inspector, who may not be aware of the APA.

Furthermore, in recent transfer pricing audits, it has also been observed that certain transfer pricing inspectors have taken a more aggressive position, even challenging aspects that are considered as tax exempt (e.g., challenging the valuation of shares even where capital gains are tax exempt). More and more transfer pricing audits are also being concluded without a common or joint agreement with the taxpayer, but based on unilateral assessments of the Special Transfer Pricing Audit Division.

While the Covid-19 pandemic has largely changed the way in which many of the transfer pricing audits are now being conducted (i.e., through virtual meetings), there have also been cases of transfer pricing inspectors insisting on physical meetings, suggesting a return to the preference to conduct on-site visits, which have been commonly conducted in the pre-pandemic times.

It is also expected that transfer pricing audits will lead to an increase in court cases, with the Belgian tax authorities wanting to bring these disputes with Belgian taxpayers to court. However, recent case law has demonstrated that the Special Transfer Pricing Audit Division will have to better prove their cases considering that the burden of proof resides with the inspectors.

In the recent case *2017/AR/1640* brought to the Court of Appeal of Antwerp, where there had been a dispute over the appropriate transfer pricing method to be applied, the court ruled that the fact that the Belgian tax authorities applied a different transfer pricing method than the taxpayer had used does not in itself demonstrate that the method applied by the taxpayer is out of line with market conditions. Particularly, simple references to the OECD Guidelines by the tax authorities were not considered enough to satisfy the burden of proof. In this case, the Special Transfer Pricing Audit Division had also been unable to deliver and submit the benchmarking analysis performed which were used to make the transfer pricing adjustments (of EUR 91 million and EUR 56 million respectively over two years). This resulted in the Court ruling in favour of the taxpayer that the position of the Belgian tax authorities has not been sufficiently substantiated and that the transfer pricing method applied by the taxpayer could not be proved to be inconsistent with the market practice.

Impact of COVID-19

Considering the impact of the COVID-19 pandemic, it may be the case that the Belgian tax authorities also pay close attention in the coming year on the application of certain Covid-19 relief measures by taxpayers (e.g., correct application of carry back of tax losses, application of Covid-19 subsidies, application of temporary unemployment, etc.), as well as changes to transfer pricing policies or restructurings that the groups have applied to cope with the pandemic.

While it is understood that there is an internal workgroup within the Belgian tax authorities handling Covid-19 related tax matters, there have been no external publications or deliverables provided to the public to date. This internal workgroup is also unlikely to be only focused on transfer pricing matters, but on a broader array of tax aspects influenced by the pandemic.

Nevertheless, from a transfer pricing perspective, considering the OECD guidance on the transfer pricing implications of Covid-19 that was published on December 18, 2020, the Belgian tax authorities are expected to draw references and guidance from that OECD guidance in dealing with such matters. Having said that, certain previous positions taken by the Belgian tax authorities may need to be reassessed when reviewing the periods impacted by Covid-19. For instance, while the OECD guidance specifies that *“loss-making companies that satisfy the comparability criteria should not be rejected on the sole basis that they suffer losses”*⁴ in periods affected by the pandemic, the Belgian tax authorities had specified in the Transfer Pricing Circular that companies with two or more years of losses should not be considered comparable to limited risk tested parties. This viewpoint may need to be reassessed considering the specific circumstances that have arisen due to the pandemic. However, as it was observed after the previous economic crisis, the Belgian tax authorities then were reluctant to allow Belgian taxpayers with limited risk functional profiles to assume losses, based on the position that, in times of exceptional and positive economic growth, the Belgian companies or PEs still only realized limited returns, and thus, in distressed times, they should similarly be protected from losses. It will be left to be seen how the Belgian tax authorities address the transfer pricing aspects concerning the latest pandemic in upcoming transfer pricing audits.

One potential solution to Covid-related pricing challenges may be for Belgian companies to apply for rulings, to obtain certainty on the new transfer pricing policies that have now been adapted to the circumstances of the Covid-19 pandemic, to draw tax certainty in times of economic uncertainty.

What Can We Expect in 2021?

Transfer Pricing Audits and Risk Assessment

While datamining is already applied by the Belgian tax authorities, it would be fair to assume that the Belgian tax authorities will continue to focus on the increased automation of the identification and execution of tax audits. It is hence imperative that taxpayers maintain the necessary documentation supporting the positions taken in their respective returns and filings.

⁴ Paragraph 33, Guidance on the transfer pricing implications of the COVID-19 pandemic, OECD (December 18, 2020).

The Belgian tax authorities have also become increasingly involved in international collaboration and multilateral (joint) transfer pricing audits - particularly with the tax authorities in the Netherlands and Austria, with whom there appears to be regular interaction. In addition, similar to some other countries in Europe, it is expected that the Belgian tax authorities may start initiating CBCR driven transfer pricing audits, as they further examine the CBCRs both submitted by qualifying groups in Belgium, and those received from foreign tax administrations through automatic exchange.

Considering the implementation of the mandatory disclosure rules under the Directive on Administrative Cooperation 6 ("DAC 6") in force in Belgium with first filings due at the end of February 2021, transfer pricing audits that are driven by the DAC 6 reported arrangements may also be anticipated, targeting potentially tax-driven cross-border arrangements that may facilitate base erosion and harmful tax practices.

The relationship between Belgian taxpayers and the Belgian tax authorities is also expected to evolve towards a relationship of proactive communication and cooperation. Since 2018, a so-called "**horizontal monitoring**" pilot project has been initiated, where a small number of large Belgian taxpayers and the Belgian tax authorities meet on a regular basis to discuss tax matters proactively. It may also be interesting to note that Belgium is also a participant in the second International Compliance Assurance Programme ("ICAP") Pilot programme aimed at facilitating multilateral co-operative risk assessment and assurance.

Digitalization of the Economy

The Belgian tax authorities are expected to support the ongoing efforts at the OECD and European levels to reform international taxation, such as in the fields of digital taxation and the tax aspects of the digitalization of the economy, and consequently give these areas the necessary attention in future audits. The new Belgian government formed in October 2020 has voiced support for the OECD proposals and has indicated that it will only introduce a Belgian digital services tax in 2023 if no international consensus is achieved.

Covid-19 Impact on Advance Pricing Arrangements and Mutual Agreement Procedures

Considering the impact that the ongoing pandemic has on the economy and various market and industry segments, it is expected that the Belgian competent authorities and Belgian ruling commission may face an increased need to reassess applicable APAs or ongoing APA applications, particularly where critical assumptions are not met. Coupled with the cancellation of face-to-face competent authority meetings, delays to APA and Mutual Agreement Procedures ("MAP") discussions and negotiations could be expected.

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