

Belgium update as of February 2007

See full text of circular letters (in French only)

1) Transfer pricing audit team (circular letter CP.221.4/A/601.321 of July 4th, 2006)

On July 1st, 2006, a specific audit team has been created, specialised in the (assistance on) audit of transfer pricing. It also covers the dealings of Belgian permanent establishments.

The transfer pricing audit team works on an autonomous basis and will also act as a knowledge centre. Its main function is providing assistance to the local audit teams across the country in case of a tax investigation (technical support and guidance) and assuring the tax audit in relation to transfer pricing of Belgian enterprises of a MNE or of the permanent establishments. It will also assist in the resolution of disputes.

The audit team assists in drafting guidance on the audit of transfer pricing as fixed by the Belgian tax administration, in conformity with the OECD guidelines, and in co-operation with the Knowledge group on transfer pricing.

In order to guarantee the legal certainty of taxpayers and to obtain uniform points of view, the transfer pricing audit team has to be informed of every investigation in the field of transfer pricing engaged by local audit teams.

The transfer pricing audit team is composed of 8 officials.

2) Application of the arm's length principle – Determining the taxable base (circular letter Ci.RH.421/569.019 of July 4th, 2006)

By law of June 21st, 2004, the arm's length principle (together with the primary adjustment and corresponding adjustment) was formally and expressly introduced in Belgian law (see CTPA/CFA/WP6/WD(2004)9/CONF). This law forms i.a. the legal basis – together with other articles in the Belgian income tax code – of adjustments to the taxable profit derived from cross border relations between associated enterprises.

The circular letter Ci.RH.421/569.019 of July 4th, 2006 discusses the introduction mentioned above and adjustments to be performed in the first operation¹ for the determination of the taxable base. It may therefore be considered to be rather a technical circular letter than a circular letter introducing certain principles.

¹ The net taxable base in corporation tax is derived through six operations : first operation : the mathematical addition of the three elements making up the taxable profit: reserves, disallowed expenses and distributed profits, second operation : the breakdown of profits according to their origin (Belgian or foreign); third operation the deduction of non-taxable items (including income attributable to PE abroad); fourth operation : the Participation Exemption deduction; fifth operation : the deduction of carry-forward losses; sixth operation : the investment deduction.

The circular letter states that the provisions of the law of June 21st, 2004 are only applicable to the following cross border commercial or financial relations² :

- between a resident company and a non-resident company both being member of the same MNE;
- between a permanent establishment situated in Belgium and a permanent establishment situated abroad of another company of the same MNE;
- between a resident company and a permanent establishment situated abroad of another resident company both being member of the same MNE;
- between a permanent establishment situated in Belgium and the foreign head office;
- between a permanent establishment situated in Belgium and a foreign permanent establishment of the same company, both establishments situated in another country than that of the head office.

The primary adjustment of the profit of the resident company is taken into consideration in the first operation through adding the adjustment to the disallowed expenses.

Introducing the corresponding adjustment in Belgian law may, as stated in the circular letter, increase the legal certainty of the taxpayers concerned. In turn, this may lead to a better investment environment in Belgium. However, it is repeated that one should only proceed to a corresponding adjustment insofar the adjustment is justified both in principle and to the amount. In other words, when the profit in the other State has been increased to a level exceeding an "arm's length profit", this provision will not apply to that excessive part. The corresponding adjustment will be taken into consideration in the taxable base through an increase of the taxable reserves at the beginning of the year.

3) Documentation requirements (circular letter Ci.RH.421/580.456 of November 11th, 2006)

a) general

The objective of this circular letter is to give general guidance that should be taken into account when a request for information or documentation (e.g. in the framework of a field audit) to the taxpayer is made when an audit on transfer pricing of a MNE is held and on the treatment of the replies on those requests. The circular letter also contains a list of useful information when transfer pricing is being analysed (see also annex 1). In any way, it is repeated that in the following non limitative cases an audit on transfer pricing may be appropriate :

- the use of tax havens and refuge countries when in those countries no value or only little value is added, as well as direct or indirect payments to establishments in tax havens or refuge countries (commissions, royalties, management fees, ...);
- the use of back-to-back arrangements with a view to hide the real essence of the transaction;
- complex arrangements and circular arrangements that add no or only little commercial or economic value;
- Belgian group entities that suffer losses in a structural way;

² The relations between a Belgian head office and its permanent establishments abroad fall within the scope of the 2nd and 3rd operation.

- business restructuring and delocalisation of establishments, specifically in relation to valuation and remuneration of intellectual property (intangibles) as well as the place where the legal and economic ownership of that IP is situated;
- invoices for services (management fees) sent at the end of the year (both incoming and outgoing invoices).

The list of information mentioned above has been drafted in conformity with Chapter V of the OECD guidelines as well as the Resolution of the Council and of the representatives of the governments of the Member States (of the European Union), meeting within the Council, of 27 June 2006 on a code of conduct on transfer pricing documentation for associated enterprises in the European Union (EU TPD)³. The circular letter confirms that the Belgian tax administration adheres to this resolution, its code of conduct as well as the EU TPD.

b) Consultation with the taxpayer – pre-audit meeting.

The circular letter mentions that in general the information necessary for an audit on transfer pricing depends on the facts and circumstances of the case. To determine the precise nature and exact scope of the information that has to be produced by the taxpayer or that can be requested by the tax administration in a specific case is not possible. However, it is recognised that an audit on transfer pricing and the subsequent documentation thereof is very complex and will depend on very diverse factors, proper to each enterprise. It is therefore appropriate that before a request for documentation is sent out, a consultation with the taxpayer takes place, if needed segmented per business unit, and the following is verified :

- what is the scope of the audit, i.e. in particular what transactions are under audit;
- what information and documentation is relevant and useful for the audit of transfer pricing for the transactions involving the Belgian enterprise;
- what documentation is present within the enterprise and can be delivered to the tax administration within a relatively short period;
- what are the (product of life) cycles (and variations thereof) that are present in the business sector concerned;
- what transfer pricing policy is being followed by the enterprise (or the group).

This pre-audit meeting allows the audit teams to give them an insight in the functioning, structure and organisation of the enterprise. This meeting also allows to discuss the list of useful information (see annex 1) with the taxpayer and to focus only on the relevant issues.

This consultation also leads to :

- minimizing costs for the enterprises;
- the taxpayer is well informed about what additional information and documentation is requested.

Excessive requests for information should be avoided. The appropriateness of the request for certain information in factual circumstances should be evaluated for each case and requests for information should in any way be adapted to each individual case. Sending out general

³ See : http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/c_176/c_17620060728en00010007.pdf

questionnaires should be avoided. This is in line with point 6 of the EU Code of conduct on documentation that provides that Member States should:

- not impose unreasonable compliance costs or administrative burden on enterprises in requesting documentation to be created or obtained;
- not request documentation that has no bearing on transactions under review;
- ensure that there is no public disclosure of confidential information contained in documentation.

As a consequence, the information / documentation requested should be limited to that information / documentation that is relevant based upon the specific characteristics of the enterprise and of the group to which the enterprise belongs. In first instance, information that is already available with the tax administration(s), should be compiled before the information is requested from the taxpayer concerned;

c) Compliance with the arm's length principle – prudent business manager

The circular letter reconfirms that the arm's length principle must be used for determining transfer pricing. When an enterprise decides to compile transfer pricing documentation, specifically in the framework of the EU TPD, it should be led by the prudent business management principle, i.e. a devoted business manager acting in accordance with economic standards and that undertakes to comply with the arm's length principle. In view of the nature of the transactions between associated enterprises, it may be necessary for the taxpayer in order to comply with the prudent business manager concept, to prepare or refer to written materials that would not otherwise be prepared or referred in the absence of tax considerations. When this information is requested, great care should be taken to balance its need for the documents against the cost and administrative burden to the taxpayer of creating or obtaining them.

In this context, it may be useful to prepare the following information, when relevant, when the enterprise opts for a pro-active approach :

- the nature and conditions (including prices) of relevant transactions. Transactions that clearly belong to a certain category (e.g. a distributor makes regular purchases of the same or similar products destined for resale) may be aggregated provide that no (or only minor) changes have occurred in the nature and / or the conditions of the transactions during the taxable period;
- the method selected on the basis of the nature and the conditions of the transactions, including a comparability analysis as defined in the OECD guidelines including a functional analysis;
- how that method has led to arm's length conditions;
- the conditions of relevant commercial dealings with third and with associated parties and budgets, projections and other documents that contain information based upon which an arm's length price is fixed, or necessary for determining any adjustments.

It is also recognised that during the taxable period, important changes or shifts may occur when an enterprise is active on a cyclic market. Those cycles may or may not coincide with an accounting period (or taxable period). It is expressly stated that these cycles should be taken into consideration.

The following may be mentioned as useful information :

- information on the associated enterprises
 - o activities
 - o structure
 - o shareholders and participations
 - o sales and operating results
 - o transactions with associated (and non associated) enterprises

- information on transactions
 - o economic circumstances
 - o size of the market
 - o competition circumstances
 - o regulatory framework
 - o technological progress
 - o ...

- information on functions performed
 - o production, assembly, ...
 - o managing sales and raw materials
 - o advertising and marketing
 - o stock management
 - o warranty management
 - o transport and storage
 - o training and formation of personal human resources
 - o supporting or auxiliary services
 - o after sales services

- information on risks assumed
 - o changes in cost structure
 - o changes or variations in prices (raw materials and finished products)
 - o changes and variations in stocks, obsolete stocks;
 - o risks connected with research and development
 - o financial risks
 - o exchange rate risks and variations in interests rates
 - o credit conditions, loan conditions and payment terms
 - o product responsibility
 - o production responsibility
 - o industrial and entrepreneurial (business) risks
 - o risks connected with assets and equipment

- information on assets used
 - o tangible assets (ownership, rents, leasing, ...)
 - o intangible assets (developments, licensing, ownership, economic ownership, protection)

d) Language of the documentation

Because of the multinational nature of the enterprise, a lot of documentation is being produced in another language than one of the official languages of Belgium. Also, for efficiency reasons,

transfer pricing reports or more and more produced on a pan-European or global scale. These reports are drafted generally in only one language used worldwide. Furthermore, the information or documentation requested may not be available with the taxpayer itself, but he must request that information or documentation with a foreign associated enterprise.

In line with the point of view of the JTPF, and in order to reduce the costs and delays associated with the translation of documents, it is not always necessary to provide the documentation in one of the official languages. Taxpayers that have the opinion that translating the documentation would be too burdensome, may consult with the audit team in order to meet the requirements of the audit.

Especially in relation to the following non-exhaustive list of documentation, a flexible approach is encouraged :

- transfer pricing reports with a pan-European or global coverage;
- group policy on transfer pricing;
- contracts with foreign parent or affiliate companies, contracts between those entities or with foreign third parties.

e) Time limits to provide the information / documentation

Because of

- the size of the information / documentation to be provided;
- the non availability of certain parts of the documentation in Belgium;
- documentation and information to be compiled specifically,

it is not possible for the taxpayer to submit information / documentation within the legally prescribed time limit of one month after the request. A longer time limit may be granted and this has to be judged with flexibility. This is also one of the elements that may be discussed during the pre-audit meeting.

f) EU Transfer Pricing Documentation

As mentioned above, the circular letter confirms that the Belgian tax administration adheres to the EU TPD and explains briefly the concept and content of the masterfile and country specific documentation as stated in the EU TPD⁴.

e) Use of pan-European databases

It may be genuinely difficult to find comparables on the Belgian market. As a consequence, it has already been accepted that taxpayers use comparables found on foreign markets (e.g. EU member countries), insofar that the necessary adjustments for the application of the comparability analysis were made.

⁴ See : http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/c_176/c_17620060728en00010007.pdf for the content of the EU TPD and the concept of masterfile and country specific documentation.

In the same context and in line with the EU TPD, comparables found through pan-European databases may not be automatically rejected. The use of such comparable data may in itself not be the reason for rejecting the comparables or may not automatically lead to imposing tax increases or tax fines.

g) smaller and less complex enterprises – small and medium-sized enterprises

The code of conduct mentioned above states that Member States undertake not to require smaller and less complex enterprises (including small and medium-sized enterprises) to produce the amount or complexity of documentation that might be expected from larger and more complex enterprises. However, that code of conduct does not define what smaller and less complex enterprises are, nor does it define small and medium-sized enterprises.

In order to give guidance to the audit teams, a reference is made to the definition of small enterprises as mentioned in article 15 (small companies) or article 16 (small groups) of the corporation law. Article 15 defines a small company as a company that does not exceed more than one of the following criteria :

- annual average of the human resources : 50;
- annual turnover, VAT excluded : 7.300.000 EUR;
- balance sheet total : 3.650.000 EUR; unless the annual average of the human resources exceeds 100.

A group is considered a small group when the group – on a consolidated basis, does not exceed more than one of the following criteria :

- annual turnover, VAT excluded 29.200.000 EUR;
- balance sheet total : 14.600.000 EUR;
- annual average of the human resources: 250.

Another reference may be the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises ⁵.

Under this recommendation, The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million. 2. Within the SME category, a small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million. Within the SME category, a micro-enterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million.

⁵ See http://eur-lex.europa.eu/LexUriServ/site/en/oj/2003/l_124/l_12420030520en00360041.pdf

List of useful information and documentation for a TP audit in Belgium

Last updated: February 2007

Annex 1 : list of useful information and documentation in the framework of a transfer pricing audit

Remark : The information should lead to a good understanding of the activities of the Belgian entities of the group. What information is provided in the best possible way, is preferably determined during a pre-audit meeting

I Situation of the company within the group

1. Presentation of the group:

The **annual consolidated accounts** of the group (or a copy of the annual report of the group).

2. A general description of the organisational, legal and operational structure of the multinational enterprise (including a organization chart, a list of the different enterprises and a description of the participation of the parent company in the subsidiaries. When available, it may be presented through a **complete and recent organization chart** of the group, mentioning the shareholdings and the percentages that are relevant for the Belgian enterprise).

3.

a) For the **Belgian entity** (parent company, subsidiary, companies belonging to a consortium, associated companies, companies in which the entity participates without controlling the company, permanent establishment, branch):

- Address of the company seat and of any other operating offices;
- VAT number; and
- Details of the competent contact person (name, position, telephone number, etc.) (e.g. tax manager)

b) For each **foreign entity** with which the Belgian entity has relations :

- Company address; and
- VAT number or fiscal identification number

II Economic role of the Belgian entity and transactions between the Belgian entities and other group members

4. A description of the different **flows of goods and services** between the Belgian entity and the foreign entities and the different members of the group concerned.

Information on the **goods (per product line or per business unit, should the case occur) and services** that involve the Belgian entity as regards:

- 1° Supply chains (third party or intra-group suppliers)
- 2° Sales chains (third party or intra-group clients)
- 3° Volumes or quantities (per country, intra-group, third party, etc.)
- 4° Invoicing flows.

5. As far as relevant for the evaluation of the transfer prices of the Belgian enterprise, the **internal structure and organisation** at the level of each group entity with which the Belgian company performs transactions; i.e. an overview of

- 1° The different services / departments and employees used;
- 2° The commercial organisation;
- 3° The operation of "local management":
 - Centralised or decentralised management;
 - The different powers and / or levels of decision;
- 4° The transactions / relations with the major distributors and agents / representatives outside the group; and
- 5° Any other useful information relating to the structure and internal organisation of the enterprise.

III Comparability analysis

6. An enumeration of **product groups** and competitive product groups in the market. In the event, the differences in the specific **characteristics** of the goods produced or services rendered by the Belgian entity and the same or similar goods or services on the free market, if necessary limited to the most important products or product groups.

7. **Functional analysis** (the form may be determined by the taxpayer. If necessary, the functional analysis may be presented in a schematic form)

7.1 A detailed description of all **functions performed** (e.g., production, assembly, research and development, rendering services, distribution, marketing, etc.);

7.2. Risks assumed

- 1° The risks assumed by the company and the costs borne to that event, by type of risk (e.g. market risks, risks of loss on investment, financial risks, credit risks, stock related risks, etc.);
- 2° When relevant for the Belgian enterprise, the entities that bear the other risks incurred by the group ? (in the event specified by nature of the risk);

7.3 **Means and assets used** (in the event at the level of the business unit)

- 1° Personnel – for example the attribution of personnel to the different activities of the enterprise or the business unit;
- 2° Assets of the enterprise (tangible, intangible, ...)
- 3° Any sub-contracting

8. Contractual terms

8.1 A description of the **contractual relations** relevant for the Belgian enterprise / entity between the group members concerned relating to **products**. In the absence of written conditions, a description of the conduct of the parties (justifiable in relation to the economic context).

8.2 A description of the **contractual relations** relevant for the Belgian enterprise / entity

between the group members concerned relating to the **rendering of services** (including "management fees", attribution of loans, ...). In the absence of written conditions, a description of the conduct of the parties in this matter (justifiable in relation to the economic context).

9. **Economic circumstances:**

When a change is noticed in the transfer pricing, the economical circumstances (general and specific) that would have influenced the application of the transfer pricing policy with regard to the Belgian enterprise / entity.

10. **Business strategies**

The business strategies that the Belgian entity is following (innovation, degree of product diversification, market penetration, etc ...)

IV Brands patents and know-how

In relation to the Belgian entities and / or the Belgian market

11. The **intangible assets** (patents, brands, trademarks, know how, ...) as well as the royalties paid and received.

12. **Licensing agreements** concluded with the foreign associated companies or foreign independent companies for the use of brands, patents, models, know-how and technical assistance.

13. **Sub-licensing agreements** concluded with the foreign associated companies or foreign independent companies for the use of brands, patents, models, know-how and technical assistance.

V CCA, APA and rulings

14. A list of the CCAs, APAs and rulings. A short description of the content may be useful.

VI Documentation on Transfer Prices

15.

- Group's transfer pricing policy and which is relevant for the Belgian enterprises
- Applicable transfer pricing method(s) ;
- Rationale for the choice of the selected method.

16. Any comparables (internal or external) used and the adjustments thereto

All useful information that can justify the choice (comparability analysis including a functional analysis).

17. Implementation of the transfer pricing method(s) by the Belgian entities.

18. All useful information supporting the transactions / relations such as standard agreements, allocations keys between group members, etc. not mentioned above.

Annex 2 :

Resolution of the Council and of the representatives of the governments of the Member States, meeting within the Council, of 27 June 2006 on a code of conduct on transfer pricing documentation for associated enterprises in the European Union (EU TPD) :

See : http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/c_176/c_17620060728en00010007.pdf