BRIEFING
EU Legislation in Progress

European Parliament

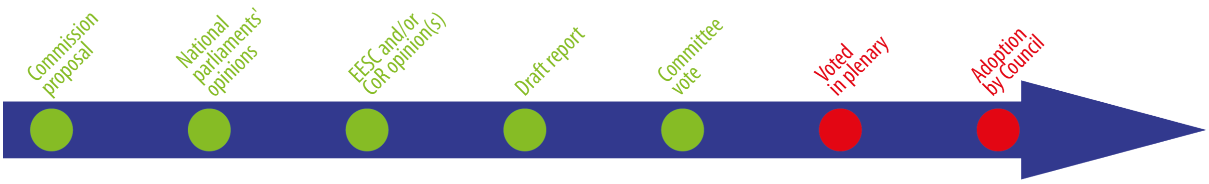
Harmonising transfer pricing rules within the EU

OVERVIEW

The pricing of goods and services traded within a multinational group is known as 'transfer pricing'. The prices charged on such transactions affect the allocation of income among the different entities of the multinational group (and consequently, the taxable profits of each country). To ensure that transactions between group entities are priced in a way that reflects their fair market value – i.e. as if the transactions were made between independent entities – countries have put in place strict transfer pricing rules. While these rules are established at the national level, EU Member States generally align with the (non-binding) OECD Guidelines. However, the number of transfer pricing tax disputes has risen over the years, with both tax authorities and companies dedicating significant time and resources to resolving such cases.

On 12 September 2023, the European Commission tabled a proposal for harmonising transfer pricing rules within the EU. The main goal is to establish a common approach at the EU level towards transfer pricing and define key transfer pricing principles to be incorporated into EU law. The European Parliament's Committee on Economic and Monetary Affairs (ECON) has drawn up a (non-binding) report, which is expected to be put to the vote during Parliament's April I plenary session (10-11 April).

Proposal for a Council directive on transfer pricing		
Committee responsible:	Economic and Monetary Affairs (ECON)	COM(2023)532 12.9.2023
Rapporteur:	Kira Marie Peter-Hansen (Greens/EFA, Denmark)	2023/0322(CNS)
Shadow rapporteurs:	Anna-Michelle Asimakopoulou (EPP, Greece) René Repasi (S&D, Germany) Gilles Boyer (Renew, France) Andżelika Anna Możdżanowska (ECR, Poland) José Gusmão (The Left, Portugal)	Consultation procedure (CNS) – Parliament adopts a non-binding opinion
Next steps expected:	Vote in plenary on ECON committee report	



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Context

An introduction to transfer pricing

When company entities within a multinational group make transactions between each other, the prices they charge in exchange for the traded goods or services are referred to as 'transfer prices'. In today's globalised economy, and with ever more complex company structures in place, these cross-border transactions within multinational groups play a significant role, representing roughly a third of total global exports according to some estimates. Strict transfer pricing rules are in place to ensure that each company entity's income reflects its real economic contribution within the multinational group. The main goal of transfer pricing law is to establish a 'proper' or 'right' price for the intra-group transactions (referred to as **'controlled transactions'**). This means that prices on controlled transactions should reflect a fair market value, i.e. similar to what would be charged if the transactions were made in an open market between unrelated parties (referred to as **'uncontrolled transactions'**).

Transfer pricing legislation has a considerable impact on companies and the wider economy. Firstly, as transfer pricing rules determine the prices charged on controlled transactions, they impact the final income and profit of each company entity of a multinational group, and thus the future corporate tax charge by the countries where those entities are located. Furthermore, when countries do not have a clear transfer pricing framework in place, this may have a negative impact on foreign direct investment and trade. An IMF study concluded that the mere introduction of transfer pricing regulations reduced investment by multinationals by more than 11 %, with stricter approaches carrying a more negative impact on investment. At the same time, a too lenient transfer pricing framework may open up opportunities for corporate tax avoidance (see 'Existing situation').

While the overall logic behind transfer pricing seems straightforward, carrying it out in practice is extremely difficult, with transfer pricing often regarded as one of the most complex topics in international tax law. Many multinationals seek the expertise of transfer pricing specialists, tax advisors and economists to ensure compliance and avoid costly double tax disputes with the tax authorities.

This briefing discusses some of the key transfer pricing concepts to provide a flavour of the domain, but it should be stressed that this remains a heavily simplified overview.

The arm's length principle

The arm's length principle (ALP) is the key foundational principle underlying transfer pricing regulations. As the name implies, a company entity of a multinational group needs to consider what prices it would charge for goods or services provided to another entity of the same company group, as if that other entity were an unrelated party (i.e. as if that other entity were at arm's length). Countries usually define how they approach the ALP in Article 9 of their bilateral tax treaties. These transfers from one company to another within the same group can cover a wide range of items, from supplying components of goods and financial loans to providing accountancy and management services.

An important feature of these transactions is the control threshold: At what point is a company considered to be related to another company for transfer pricing purposes? These control thresholds vary between EU Member States. For example, in Germany a company is considered to be an **'associated entity'** to another party if the company holds a stake of at least 25 % in the other party (voting rights, company assets, etc.). In Greece, this level is set at > 33 %, and > 50 % in Finland.

Comparability analysis

To prove that the transfer price charged by the company on its controlled transaction could be considered appropriate – that is, in line with the ALP – a company has to undertake a comparability analysis. In this comparability analysis, the company must accurately define the controlled transaction that has taken place, looking at the economically relevant circumstances surrounding the transaction and the commercial or financial relations between the associated entities involved. Five factors are looked at in detail:

Table 1 – Comparability factors in transfer pricing

Comparability factors	Example
The contractual terms of the transaction	Payment terms, delivery terms, sales volume, etc.
The functions performed, taking into account assets used and risks assumed	Role of the associated entities involved (manufacturing, distributing, marketing, etc.), assets involved (offices, machines, patents, etc.), risks assumed by the associated entities (liability risk, foreign exchange risk, regulatory risk, etc.)
The characteristics of the goods transferred or services provided	Product characteristics (branding, type, quality, etc.)
The economic circumstances of the parties and of the market in which the parties operate	Consumer purchasing power, geographical location, level of competition in market, labour and capital cost, etc.
The business strategy pursued by the parties	Development of new product, market expansion, market development, etc.

Source: OECD Guidelines, 2022.

Having accurately defined and delineated the controlled transaction through these comparability factors, the company will look next for (internal or external) **'comparables'** – transactions carried out between or with unrelated parties which are sufficiently similar to the controlled transaction.[1] Companies mainly make use of commercial databases and other online sources (company websites, financial reports, etc.) to find such comparables.

Identifying these comparables is in no way an easy task. A true comparable – with identical comparability factors – may just be non-existent. That is why countries require comparables to be sufficiently 'similar' – rather than identical – to the controlled transaction. Even then, companies may still deem the search for comparables to be extremely complex. For instance, some transactions involve relatively unique and valuable intangibles (e.g. patents), for which a similar comparable may not really exist, potentially giving rise to disagreement between the company and the tax authorities on how such an intangible should be valued for transfer pricing purposes.

Transfer pricing methods

After having identified comparables, a company needs to establish whether the price of its controlled transaction is in line with the ALP. To do this, companies make use of one of the recognised 'transfer pricing methods'. These methods allow companies to calculate an arm's length transfer price by making a comparison of the price, margin or profits from the controlled transaction with the price, margin or profits in the chosen comparables. Countries usually allow five different methods: **comparable uncontrolled price (CUP) method, cost plus method, resale price method, transaction net margin method, and the profit split method**.[2] Companies have to use the transfer pricing method that would be 'most appropriate' in relation to the circumstances of the case (and not be motivated by choosing the method that would lead to the lowest tax liability). Each method has its own requirements, requiring higher or lower levels of comparability, each has its own respective strengths and weaknesses, and each may be more suited for a particular scenario than others. Countries also usually leave room for businesses to use methods other than those listed above, on the condition that the business can show that this other method provided a better solution in line with the ALP than the more traditional methods. On the basis of one of the methods, the company can calculate an **arm's length result**. While a single arm's length transfer price figure is theoretically possible, in reality businesses will often identify a series of comparable transactions and arrive at a range of appropriate transfer prices (**'arm's length range'**).

While a full explanation of the workings of each method would go beyond the objective of this briefing, the box below contains a simplified example of how the resale price method works.

Example – Resale price method

As the name suggests, the 'resale price method' calculates an arm's length transfer price by looking at the resale price charged to an unrelated customer by the selling entity on a product that was bought from an associated entity.

Suppose there is a multinational enterprise with two related entities: Company A (a bicycle manufacturer) and Company B (a distributor of the bicycles). Company A assembles and sells bicycles to Company B, which resells the bicycles to independent customers for €1 000.

Company A needs to consider what the arm's length price would be for the sale of the bicycles to Company B. The resale price method takes into account the resale price of Company B (€1 000) and the gross profit margin (gross profit/net sales) realised by Company B on the sale. Beyond the acquisition cost of the bicycles itself, Company B will need to cover costs such as operating expenses, marketing costs, and other business-related expenses. Depending on the amount of value Company B adds in the process, this profit margin will be higher.

To keep it simple, we will assume that the results of the comparability analysis show that a 15 % gross profit margin is common among comparables (i.e. the profit margin earned by independent enterprises in comparable uncontrolled transactions).

Company A can now calculate the arm's length price, based on the resale price method, in the following way:

Arm's length result = *Resale price - (gross profit margin × resale price)*

Arm's length result = *€1 000 - (15 % × €1 000)*

Arm's length result = *€850*

Therefore, the arm's length transfer price for the product from Company A to Company B, based on the resale price method and a 15 % gross profit margin, should be €850.

Transfer pricing documentation

To show that their transfer pricing framework is in line with the arm's length standard, companies have to collect and file documentation with the tax authorities, outlining the results of the comparability analysis. This is usually a three-tiered process: a country-by-country report, a master file, and a local file.

- Country-by-country report: This contains general information about the company group's income, tax burden and economic activity per country in which the group is operating. This is filed with the parent entity's local tax authority, and then shared between tax authorities.
- In the master file, the company group provides high-level information regarding its organisational structure, the kind of goods or services it trades, etc. This is made available to all relevant tax administrations.
- In the local file(s), information on the controlled transactions specific to each country is collected, along with the company's analysis of the transfer pricing determinations they have made with regard to those transactions.

Collecting this documentation is time-consuming – it is not exceptional for transfer pricing documentation to run into hundreds of pages – and different countries may have different specific content or linguistic requirements in place. Incomplete documentation may result in penalties for the companies.

Transfer pricing adjustments

When the price of the controlled transaction is not considered to be in line with the arm's length principle, an adjustment can be made. The table below shows three key adjustments:

Table 2 – Transfer pricing adjustments[3]

Type of adjustment	Definition	Example
Compensating adjustment	An adjustment made by the taxpayer in order to comply with the ALP before the tax return is filed.	When finalising its transfer pricing analysis, company entity X, resident in Country A, realises it has regularly undercharged company entity Y, resident in Country B. Before the final tax returns are declared, X and Y 'correct' the incomes of both company entities (e.g. by adjusting the accounting entries).
Primary adjustment	An adjustment made by the tax administration to a company's profits, when the tax administration believes the transfer prices charged were not in line with the ALP.	The tax authority of Country A finds that resident company entity X undercharged company entity Y, resident in Country B. It therefore performs an upward adjustment to the income declaration of company entity X (resulting in a higher tax burden for X).
Corresponding adjustment	The (logical) follow-up to the primary adjustment. When a primary adjustment is made in one country, a corresponding adjustment is made in the other country in order to avoid double taxation.	Following on from the above, the tax authority of Country B is made aware of the primary adjustment performed by Country A. If the tax authority of Country B agrees with the primary adjustment, it will perform a corresponding downward adjustment to the income declaration of resident company entity Y (resulting in a lower tax burden for Y). Therefore, the allocation of profits between the two countries is consistent.

Source: OECD Guidelines, 2022.

The efficient interaction between primary and corresponding adjustments is of key importance for companies. When a primary adjustment is made in one country, without a corresponding adjustment in the other country, the company group will likely face double taxation.

Existing situation

OECD transfer pricing guidelines

At the moment, there is no common binding transfer pricing regulation at EU level. For their national transfer pricing rules, EU Member States generally rely on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.[4] Approved officially in 1995 by the OECD Committee on Fiscal Affairs, the OECD Guidelines have been a reference framework for developed countries' transfer pricing regulations. The Guidelines have been regularly updated over time, with the last edition published in January 2022.

While the Guidelines provide a detailed framework for how countries should apply transfer pricing rules (the latest edition runs into more than 600 pages), they are by nature **non-binding** and are issued as a **'recommendation'** to the OECD's member countries.[5] As a result, there are a number of differences between EU Member States' transfer pricing rules, with countries taking either a stricter or more flexible approach on some issues than the OECD.

Moreover, aside from the fact that not all EU Member States are members of the OECD, the legal status of the OECD Guidelines in each Member State is not always clear. Some Member States provide a direct reference in their national transfer pricing legislation to the OECD Guidelines, while others do not refer to the Guidelines (despite following them in practice). As the OECD Guidelines are regularly updated – with the last update taking place in 2022 – it is not always clear from national legislation whether a Member State is following the latest version of the OECD Guidelines or whether they follow the Guidelines as interpreted at a specific point in time.[6]

The EU and transfer pricing

Transfer pricing rules themselves are not part of the EU legal framework, with Member States deciding at domestic level their transfer pricing legislation. However, over the years the EU has taken several (both soft- and hard-law) initiatives to either prevent transfer pricing disputes, or, when they do occur, to solve them as quickly as possible.

EU Arbitration Convention

The intergovernmental Arbitration Convention, signed in 1990, lays down a general binding procedure when double taxation disputes occur. A common timeline is established for tax authorities to resolve the dispute, with further rules concerning the setting up of an advisory commission, which provides a non-binding opinion on the dispute case.

EU Joint Transfer Pricing Forum

Set up informally in 2002, the Joint Transfer Pricing Forum was an advisory EU platform on transfer pricing. Tax officials from each EU Member State were represented in the platform, as well as 18 stakeholder members (such as Volvo, Eurodad and the Federation of German Industries). The platform discussed transfer pricing issues, sought where to improve the Arbitration Convention, and would assist and advise the Commission in finding practical non-legislative solutions in order to achieve more uniform application of transfer pricing rules. The platform's mandate ended in 2019.

EU Dispute Resolution Mechanism

The EU Directive on a Dispute Resolution Mechanism, supported by the Council in 2017, builds further on the Arbitration Convention and ensures that, when businesses are faced with double taxation, fixed deadlines are put in place in which Member States endeavour to resolve the dispute.

European Trust and Cooperation Approach

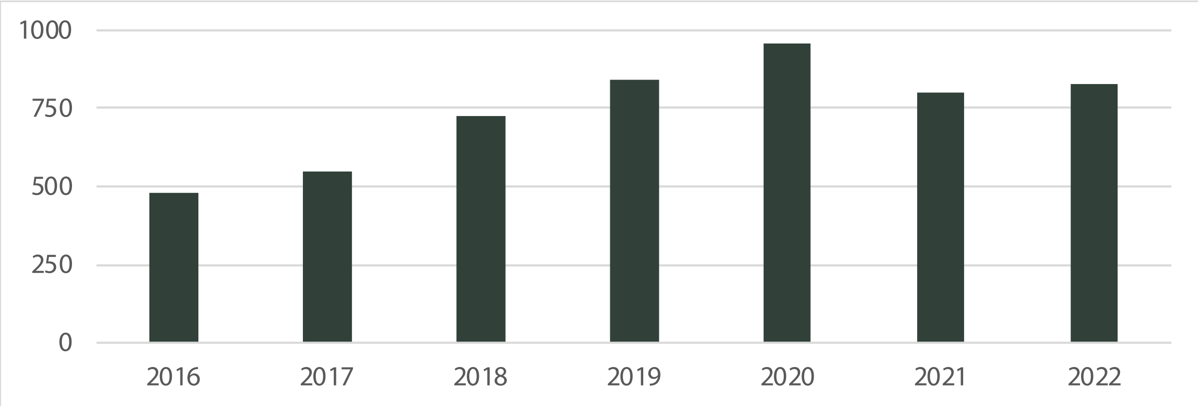
The European Trust and Cooperation Approach (ETACA) was a pilot project organised by the European Commission in 2020, in which a number of large enterprises and the tax authorities of 14 Member States participated. ETACA's main objective was to prevent (transfer pricing) tax disputes by establishing enhanced cooperation between companies and tax authorities. The Commission is currently evaluating whether ETACA could be continued on a more permanent basis.

Double taxation disputes

As the OECD Guidelines themselves put it: **'transfer pricing is not an exact science'**.[7] The inherent complexity of transfer pricing, combined with the different application of the rules in different countries makes disputes nearly unavoidable. When countries disagree about the transfer price charged – or, in other words, when a primary adjustment is made in one country without a corresponding adjustment in another country – double taxation arises (see Table 2). Compensating adjustments may also be a cause of double taxation, as their acceptance varies among EU countries. The rise of the digital economy has further complicated transfer pricing, causing disagreements between companies and tax authorities over the valuation of highly unique intangibles.[8]

Solving transfer pricing disputes requires a lot of time and effort for both the business and the tax authorities involved. Mutual Agreement Procedures (**MAPs**) are opened between the company group and tax authorities in order to find an arm's length price that is acceptable to the tax authorities (of two or more jurisdictions) involved. The number of MAPs opened in the EU under the Arbitration Convention rose by 72 % between 2016 and 2022 (see Figure 1). Both companies and tax authorities have to spend resources on legal advice during these MAPs, sometimes for many years, without the guarantee that the double taxation will be resolved. In the OECD Inclusive Framework, MAPs related to transfer pricing disputes took, on average, 29 months to complete in 2022. Furthermore, a 2024 survey by Ernst & Young showed that many large groups are worried that the recently introduced global minimum corporate tax may give rise to further disputes about transfer pricing, leading to double taxation. The arrival of public country-by-country tax reports is also impacting companies' transfer pricing policy, the survey revealed.

Figure 1 – Number of transfer pricing dispute cases opened in the EU under the Arbitration Convention (2016-2022)[9]



Data source: Statistics on pending Mutual Agreement Procedures (MAPs), DG TAXUD.

However, transfer pricing may also be abused for corporate tax avoidance purposes. The logic is straightforward: when a company resident in a low-tax jurisdiction charges a high price for a good or service to an associated entity resident in a high-tax country, income will flow from the high-tax to the low-tax country, effectively lowering the overall corporate tax burden of the multinational group.[10] A number of initiatives have been agreed at the OECD to further strengthen transfer pricing rules and reduce the risk of companies using transfer pricing to deliberately lower their corporate tax payments.

However, some academics and stakeholders have advocated doing away with transfer pricing altogether and replacing it with an alternative system – formulary apportionment – whereby corporate entities' income would be allocated to countries according to a formula. Such a system could lower the likelihood of tax avoidance and simplify the overall corporate tax system, but could also have consequences in terms of tax revenue distribution between countries.[11]

The changes the proposal would bring

The Commission tabled its proposal for a Council directive on transfer pricing on 12 September 2023. The impact assessment was carried out jointly with that of the proposal for Business in Europe: Framework for Income Taxation (BEFIT), which was tabled by the Commission on the same day.[12]

The Commission's objective is to establish a **common approach to transfer pricing in the EU**. A more harmonised approach should lead to simplification of the rules and lower costs for both businesses and tax administrations, increase tax certainty, and reduce instances of double taxation and double non-taxation, the Commission argues. Once adopted, the transfer pricing proposal should come into force as of 1 January 2026.

To bring transfer pricing under EU law, the proposal first puts forward a series of definitions covering key transfer pricing concepts (Article 3). The Commission aims to streamline these definitions with those of the OECD Guidelines (see the Glossary for comparison) and clarifies the status of the OECD Guidelines. The concepts covered are:

- arm's length principle, arm's length range and arm's length result;
- permanent establishment and independent enterprises;
- primary and corresponding and compensating adjustment;
- transfer pricing methods;
- comparable uncontrolled price (CUP) method, cost plus method, resale price method, transaction net margin method and profit split method;
- comparability analysis, controlled transactions and comparable uncontrolled transactions;
- multinational enterprise group;
- cost contribution arrangement.

To ensure that the ALP is applied in a harmonised way across the EU, the directive lays down a common definition of 'associated enterprises' in Article 5. The Commission's definition sets out a **25 % shareholding threshold** or having 'significant influence' over the business, above which companies would be deemed to be associated entities.

The proposal also brings into EU law some key elements of transfer pricing. Article 11 lays down the comparability factors in EU law that companies need to consider when undertaking a comparability analysis: the business strategies pursued by the parties, the characteristics of the good or service that is being traded, the economic circumstances of the transaction, the contractual terms, and the functions performed by each of the parties to the transaction, taking into account assets used and risks assumed (see Table 1 for comparison).

Article 9(1) establishes the five recognised OECD transfer pricing methods in EU law. Similar to the OECD Guidelines, the directive leaves open the possibility for taxpayers to use other methods, subject to certain conditions (see Table 3).

Table 3 – The use of 'other methods'

Article 9(2) – Proposal for a Council directive on transfer pricing	Paragraph 2.9 – OECD Guidelines
Member States shall allow for the application of any other valuation methods and techniques to estimate the arm's length price only if it can be demonstrated in a satisfactory manner that: *(a) none of the methods referred to in paragraph 1 is appropriate or workable in the circumstances of the case;* *(b) the selected valuation method or technique is consistent with the arm's length principle and provides a more reliable estimate of the arm's length result than the methods listed in paragraph 1.*	*Moreover, MNE groups retain the freedom to apply methods not described in these Guidelines (hereafter 'other methods') to establish prices provided those prices satisfy the arm's length principle in accordance with these Guidelines. Such other methods should however not be used in substitution for OECD-recognised methods where the latter are more appropriate to the facts and circumstances of the case.* *In cases where other methods are used, their selection should be supported by an explanation of why OECD-recognised methods were regarded as less appropriate or non-workable in the circumstances of the case and of the reason why the selected other method was regarded as providing a better solution.*

Source: European Commission, 2023 and OECD Guidelines, 2022.

While the directive does not express any ex-ante preference for a method, it specifies that 'the most appropriate transfer pricing method' should be chosen, taking into account several criteria, aligned with those of the OECD.

Table 4 – Choice of transfer pricing method

Article 10 – Proposal for a Council directive on transfer pricing	Paragraph 2.2 – OECD Guidelines
The most appropriate transfer pricing method shall be selected from among the transfer pricing methods set out in Article 9, taking into consideration the following criteria: *(a) the respective strengths and weaknesses of the transfer pricing methods;* *(b) the appropriateness of a transfer pricing method in view of the nature of the controlled transaction, determined in particular through an analysis of the functions undertaken by each enterprise in the controlled transaction, taking into account assets used and risks assumed;* *(c) the degree of comparability between the controlled and uncontrolled transactions, including the reliability of comparability adjustments, if any, that may be required to eliminate differences between them;* *(d) the availability of reliable information needed to apply the selected transfer pricing method.*	*The selection of a transfer pricing method always aims at finding the most appropriate method for a particular case. For this purpose, the selection process should take account of* *the respective strengths and weaknesses of the OECD recognised methods;* *the appropriateness of the method considered in view of the nature of the controlled transaction, determined in particular through a functional analysis;* *the availability of reliable information (in particular on uncontrolled comparables) needed to apply the selected method and/or other methods;* *the degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments that may be needed to eliminate material differences between them.*

Source: European Commission, 2023 and OECD Guidelines, 2022.

According to Article 12, an arm's length range should be determined using the 25 % to 75 % **interquartile range** of the results of the uncontrolled comparables. Arm's length results that fall outside that interquartile range should be subject to an adjustment by Member States.[13]

To address double taxation and legal uncertainty, the proposal sets out common rules as to when and how both corresponding adjustments (Article 6) and compensating adjustments (Article 7) should be performed. A key provision is the introduction of a new **'fast-track procedure'** through which Member States can perform the corresponding adjustment within 180 days. This fast-track procedure is envisioned to replace the (lengthy) MAP in those cases where there is no doubt that the primary adjustment was made for well-founded reasons.

In Article 13(2), the Commission envisages adopting delegated acts to achieve a common approach to transfer pricing **documentation requirements** (EU-wide templates, harmonised linguistic requirements, etc.)

National parliaments

National parliaments were invited to send a reasoned opinion under the subsidiary control mechanism).

The Swedish Parliament argued that the proposal was in breach of the subsidiarity principle, underlining that it was essential for each country to have the flexibility to decide for itself how it wants to relate its national transfer pricing framework to the OECD Guidelines. This flexibility allows for increased tax certainty for companies. At the same time, the Swedish Parliament stressed the importance of Member States' national competence in matters of taxation and that this must be safeguarded.

Stakeholder views[14]

The International Chamber of Commerce (ICC) argued that the directive should be 'a perfect mirror' of the OECD Guidelines if the objective of increased certainty for companies is to be attained. The ICC criticises some of the differences between the Guidelines and the EU's proposed directive. In particular, the proposed control threshold of 25 % would bring many companies under transfer pricing law, making it particularly difficult for those companies to gather all the required data to comply with transfer pricing documentation requirements, the ICC argues. The ICC encouraged the Commission and Member States to re-establish the Joint Transfer Pricing Forum.

Similarly, Tax Advisers Europe (CFE) issued an opinion statement on the proposed directive. The organisation argued that the proposed directive would not increase tax certainty, and that some of the proposed EU rules would be stricter than the OECD's (referring, for example, to the proposed rules concerning the arm's length range).

Legislative process

The Commission tabled the proposal for a transfer pricing directive on 12 September 2023. The proposal is subject to the special legislative procedure, requiring unanimous support in the Council, following consultation of the European Parliament and the European Economic and Social Committee (CNS 2023/0322).

In Parliament, the proposal was assigned to the Economic and Monetary Affairs Committee (ECON), with Kira Marie Peter-Hansen (Greens/EFA, Denmark) as rapporteur. Her draft report was published on 16 November 2023. The final report, which the ECON committee adopted on 22 February 2024, expresses strong support for the proposal, welcoming its focus on the decrease in cases of both double taxation and double non-taxation. The report insists on advancing the enforcement of the directive by a year. Additionally, it suggests relaunching the EU Joint Transfer Pricing Forum and extending the duration of the ETACA initiative. It furthermore proposes to take into account the possibility that the directive may need to align in the future with the United Nations' guidelines on transfer pricing, rather than the OECD's. Parliament is scheduled to vote on the (non-binding) report during its April I plenary session (10-11 April).

In the Council, the proposal is being discussed in the Working Party on Tax Questions (Direct Taxation).

SOURCE

To access all procedural documents:

Transfer pricing, Legislative Observatory (OEIL), European Parliament.

ENDNOTES

1 'External comparables' are transactions made between two unrelated third parties, neither of whom is a participant in the controlled transaction. 'Internal comparables' are transactions that take place between the company undertaking the comparability analysis and an independent third party.

2 For a detailed explanation of each method, see OECD Guidelines, 2022, paragraphs 2.13 to 2.187.

3 A fourth category is that of 'secondary adjustments', whereby further adjustments are made to the initial primary adjustment, by adjusting the cash accounts of the taxpayer.

4 The United Nations has a Practical Manual on Transfer Pricing (2021), whose rules are mostly followed by developing countries. While the general framework is similar to that of the OECD's, there are some (slight) differences, mainly to accommodate the smaller capacity of tax administrations in developing countries.

5 The legal status of the OECD Guidelines (as well as that of the OECD Model Convention) has been a source of discussion among legal and tax scholars. See, for example, Vega A., 'International Governance Through Soft Law: The Case of the OECD Transfer Pricing Guidelines', Working Paper of the Max Planck Institute for Tax Law and Public Finance No 2012-05, 2012.

6 This is usually referred to as the 'static vs. dynamic' approach in the academic literature on the legal status of (tax) treaties.

7 See OECD Guidelines, 2022, paragraph 1.13.

8 See, for example, Murphy H., Facebook accused of downplaying IP value in $9bn US tax case, Financial Times, 2020, and Waters R., Microsoft says IRS has demanded $28.9bn in back taxes, Financial Times, 2023.

[9] The graph shows exclusively double taxation cases that are referred to a Mutual Agreement Procedure (MAP). It can be assumed that there are more cases of double taxation happening, but that businesses may not always refer these cases to MAPs, as the time and legal costs of this procedure may exceed the cost of double taxation itself.

[10] For more information on the connection between transfer pricing and profit shifting, see, for example, Choi et al., Transfer pricing regulation and tax competition, J. Int. Econ., 127, 2020, p.103367.

[11] The Commission proposed introducing formulary apportionment for large enterprises as part of its directives for a Common Consolidated Corporate Tax Base (CCCTB) in 2011 and 2016. However, the CCCTB directives were withdrawn as unanimous support could not be found in the Council. The CCCTB initiative was replaced by the BEFIT proposal (see endnote 12).

[12] BEFIT establishes a common corporate tax base for multinational groups operating in the EU, and lays down a general formula to divide the profits between the company entities. Unlike the CCCTB, BEFIT does not propose to introduce formulary apportionment for large enterprises, but rather keeps this as a potential avenue for the future. The Council is currently negotiating this proposal.

[13] Unless the facts and circumstances justified choosing an arm's length result outside the proposed interquartile range.

[14] This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal.

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