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**Ricardo Sergio Schmitz Filho**

Doctoral Dissertation

# A REIMAGINED ARM'S LENGTH STANDARD

SOCIAL SCIENCES,
LAW (S 001)
VILNIUS, 2026

FACULDADE DE DIREITO
UNIVERSIDADE DE LISBOA

Mykolas Romeris University

THE FACULTY OF LAW OF THE UNIVERSITY OF LISBON
MYKOLAS ROMERIS UNIVERSITY

**Ricardo Sergio Schmitz Filho**

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LISABONOS UNIVERSITETO TEISĖS FAKULTETAS
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**Ricardo Sergio Schmitz Filho**

# A REIMAGINED ARM'S LENGTH STANDARD

Mokslo daktaro disertacija
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*"Castelos nascem dos sonhos, para no real achar seu lugar"*
**Oswaldo Montenegro**

***To my grandmother, Leny***
***To the love of my life, Justina***

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## ABBREVIATIONS LIST

| | | |
|---|---|---|
| **2018 Interim Report** | - | Interim Report on Tax Challenges Arising from Digitalisation |
| **2019 Pillar I Public Consultation** | - | Public Consultation Document on the Secretariat Proposal for a 'Unified Approach' under Pillar One |
| **2019 Pillar II Public Consultation** | - | |
| **2019 Policy Note** | - | Policy Note on Addressing the Tax Challenges of the Digitalisation of the Economy |
| **2019 Programme of Work** | - | Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy |
| **2019 Public Consultation** | - | Public Consultation Document on Addressing the Tax Challenges of the Digitalisation of the Economy |
| **2024 Amount B Report** | - | OECD Report on Pillar One – Amount B |
| **Action Plan** | - | 2013 Action Plan on Base Erosion and Profit Shifting |
| **AG** | - | Advocate General |
| **Alki** | - | Alki LP |
| **ALS** | - | Arm's length standard |
| **AOA** | - | Authorized OECD Approach |
| **AOE** | - | Apple Operations Europe |
| **APA** | - | Advance pricing arrangement / agreement |
| **ASI** | - | Apple Sales International |
| **BALRM** | - | Basic Arm's Length Return Method |
| **BEFIT** | - | Business in Europe: Framework for Income Taxation |
| **BEPS** | - | Base Erosion and Profit Shifting |
| **BMR** | - | Best Method Rule |
| **Brazilian Transfer Pricing Rules** | - | Lei No. 9.430, of 27 December 1996, Provides for federal tax legislation, social security contributions, the administrative consultation procedure, and other provisions, Diário Oficial da União, 30 December 1996 |
| **CAPM** | - | Capital asset pricing model |

| | | |
|---|---|---|
| **CCCTB** | - | Common Consolidated Corporate Tax Base |
| **CCTB** | - | Common Corporate Tax Base |
| **CIT** | - | Corporate income tax |
| **CJEU** | - | The Court of Justice of the European Union |
| **CP** | - | Cost-plus |
| **CPM** | - | Comparable Profits Method |
| **CUP** | - | Comparable uncontrolled price |
| **DEMPE** | - | Development, enhancement, maintenance, protection and exploitation |
| **DST** | - | Digital services tax |
| **EC** | - | European Commission |
| **EC Notice** | - | European Commission Notice on the Notion of State Aid as Referred to in Article 107(1) of the Treaty on the Functioning of the European Union |
| **ECJ** | - | European Court of Justice |
| **EGC** | - | European General Court |
| **EU** | - | European Union |
| **FASS** | - | Formulaic-Approach Simplification Safeguard |
| **FBA** | - | Formula-based alternatives |
| **FCA** | - | Fiat Chrysler Automobile NV |
| **FFT** | - | Fiat Finance and Trade Ltd. |
| **GloBE** | - | Global Anti-Base Erosion |
| **HTVI** | - | Hard-to-value intangible |
| **HTVI** | - | Hard to value intangibles |
| **LFBA** | - | Light Formula-Based Alternative |
| **LuxOpCo** | - | Amazon EU Sàrl |
| **LuxSCS** | - | Amazon Europe Holding Technologies SCS |
| **LVAS** | - | Low Value Adding Services |

| | | |
|---|---|---|
| **MAM** | - | Most Appropriate Method |
| **MI** | - | Marketing Intangibles |
| **MLI** | - | Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting |
| **MNE** | - | Multinational enterprises/corporate groups |
| **MRPS** | - | Modified Residual Profit Split |
| **MS** | - | Member State of the European Union |
| **OECD** | - | The Organisation for Economic Co-operation and Development |
| **OEEC** | - | Organisation for European Economic Co-operation |
| **PSM** | - | Profit Split Method |
| **R&D** | - | Research and development |
| **RBC** | - | Rational Business Conduct |
| **RP** | - | Resale price |
| **SCTC** | - | Starbucks Coffee Trading SARL |
| **SEP** | - | Significant Economic Presence |
| **SMBV** | - | Starbucks Manufacturing EMEA BV |
| **SMR** | - | Sequential Method Rule |
| **TFDE** | - | Task Force on the Digital Economy |
| **TFEU** | - | Treaty on the Functioning of the European Union |
| **TNMM** | - | Transactional Net Margin Method |
| **Transfer Pricing Directive Proposal** | - | Directive Proposal on Transfer Pricing Rules and on a Common Framework for Transfer Pricing in the European Union |
| **UP** | - | User Participation |
| **US / USA** | - | United States of America |

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# CHAPTER 1. INTRODUCTION

The arm's length standard (**"ALS"**) has been a cornerstone of international tax law, aiming at ensuring that transactions between associated parties, in the context of multinational enterprises/corporate groups (**"MNE"**), are conducted as if they were between unrelated parties. Conceived in the early 20th century[1], the ALS has undergone significant scrutiny since its inception, being subject to continual reassessment and debate, and hence evolving from both a *time* and *space* perspective.

Its contours were, and increasingly *are* reshaped, in the attempt to allow the arm's length to cope up with the challenges to its effective application, posed by evolving economic scenarios. The *elasticity* of the arm's length's contours, emerging from said reshaping, reveals the international community's political will to adhere to *some* notion of arm's length (rather than opting for a rupture with it) when dealing with the income tax issues arising from associated party transactions in an international context[2].

The introduction of new methods to the OECD Transfer Pricing Guidelines, in 1995[3], following the *crisis* with the traditional methods, marked a significant departure from the inaugural understanding of the arm's length standard[4]. Nevertheless, rather than advocating for the abandonment of the arm's length, the international community's political message, strongly embodied within the then new Guidelines[5], emphasized the will to adapt and reshape the framework of the arm's length standard, or its *concept*, to instead accommodate the introduced features[6]. Hence the elasticity of the arm's length contours.

The same message was strongly embodied later in the 2010's, with the unfolding of the Base Erosion and Profit Shifting (**"BEPS"**) Project[7]. Especially within its Actions 6,

1 For an historic perspective of the arm's length standard, *see*, e.g. Avi-Yonah, Reuven S. "Klaus Vogel Lecture 2023: The Past, Present and Future of Destination-Based Income Taxation." *Bulletin for International Taxation* 78, no. 2 (2024); Pankiv, Marta. *Contemporary Application of the Arm's Length Principle in Transfer Pricing.* The Netherlands: IBFD, 2017.

2 Avi-Yonah, Reuven S. *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation.* Public Law and Legal Theory Working Paper Series, no. 92; John M. Olin Center for Law & Economics Working Paper, no. 07-017. University of Michigan, September 2007: 22-23.

3 Organisation for Economic Co-operation and Development (OECD). *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 1995.* Paris: OECD Publishing, 1995.

4 Avi-Yonah, *The Rise and Fall of Arm's Length, op. cit.*, 20 ff.

5 OECD, *Transfer Pricing Guidelines* (1995), *op. cit.*, I-1 ff.

6 A *reimagination* process of the arm's length standard, notedly not commonly referred to in the doctrine as such, was already very much perceivable at that point in time.

7 Organisation for Economic Co-operation and Development (OECD). *Action Plan on Base Erosion and Profit Shifting.* Paris: OECD Publishing, 2013.

7 and 8-10[8], the OECD aimed at systematically addressing the challenges faced by the misalignments between its then current ALS and the underlying economic reality of MNE, i.e., the increasing difficulty in aligning arm's length's results with the changing notion of value creation, significantly influenced by the advent of the global and digital economy. The arm's length's main role, to serve as a profit allocation mechanism[9], gradually shifted towards being an anti-tax avoidance mechanism[10].

A similar message can be found, more recently in the 2020's, starting with the OECD 2019 Report on Addressing the Tax Challenges of the Digitalization of the Economy[11], culminating in the OECD Two Pillars Proposal[12]. These restated the will of the international community to adhere to an ALS, even when its contours continue to be reshaped, and its roles expanded into an international taxing rights (or *wealth*) redistribution and an anti-tax competition mechanism. The latter proposal is as well being adopted in the context of the European Union[13].

Also in Europe, the strong advocacy of the European Commission (**"EC"**), initially embodied in its 2016 Notice on State aid[14], and then recently *boosted* within the 2023

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8 Detailed findings of the OECD under the mentioned actions can be found in their respective final reports: Organisation for Economic Co-operation and Development (OECD). *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances: Action 6 - 2015 Final Report.* Paris: OECD Publishing, 2015; Organisation for Economic Co-operation and Development (OECD). *Preventing the Artificial Avoidance of Permanent Establishment Status: Action 7 - 2015 Final Report.* Paris: OECD Publishing, 2015; and Organisation for Economic Co-operation and Development (OECD). *Aligning Transfer Pricing Outcomes with Value Creation: Actions 8-10 - 2015 Final Reports.* Paris: OECD Publishing, 2015.

9 As initially thought. *See*, e.g., Ekkehart Reimer and Alexander Rust, eds. *Klaus Vogel on Double Taxation Conventions.* 4th ed. Amsterdam: Wolters Kluwer, 2015, 597; Luís Eduardo Schoueri. "Arm's Length: Beyond the Guidelines of the OECD." *Bulletin for International Taxation* 69, no. 12 (2015): 8-10.

10 Alexander Rust, eds, *Klaus Vogel on Double Taxation Conventions*, *op. cit.*, 598.

11 Organisation for Economic Co-operation and Development (OECD). *Addressing the Tax Challenges of the Digitalization of the Economy – Public Consultation Document.* Paris: OECD Publications, 2019. Organisation for Economic Co-operation and Development (OECD). *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy.* Paris: OECD Publications, 2019. For an overview: Ana Paula Dourado. "Editorials: Transfer Pricing in the Digital Economy." *Intertax* 47, no. 12 (2019): 998–999.

12 Organisation for Economic Co-operation and Development (OECD). *Addressing the Tax Challenges of the Digitalisation of the Economy: Policy Note.* Paris: OECD, January 2019. For a first assessment of the inaugural two pillars proposal statement, *see*: Pistone, Pasquale, João Félix Pinto Nogueira, Betty Andrade, and Alessandro Turina. "The OECD Public Consultation Document 'Secretariat Proposal for a Unified Approach' under Pillar One: An Assessment." *Bulletin for International Taxation* 74, no. 1 (2020).

13 Council of the European Union. *Directive (EU) 2022/2523 of 14 December 2022 on Ensuring a Global Minimum Level of Taxation for Multinational Groups in the Union.* Official Journal of the European Union, L 328, 22 December 2022, 1–44.

14 European Commission. *Commission Notice on the Notion of State Aid as Referred to in Article 107(1) of the Treaty on the Functioning of the European Union.* 2016/C 262/01.

Transfer Pricing Directive Proposal[15], under the Business in Europe: Framework for Income Taxation (**"BEFIT"**) context[16], corroborate with the understanding of the regional political preference towards the maintenance of a *certain* arm's length standard.

In parallel to the time evolution (and consequent *time variants*) of the ALS, different applicators, even if constrained by similar *time* placements, have not rarely disagreed on what an arm's length *result* should be, especially in recent times, minding the increasing complexities of the economy and underlying associated parties' business *rationale*. Increasingly, hence, elements such as the different levels of tolerance towards comparability requirements and towards approximation of the arm's length results have also led to different (*practical*) understandings of the arm's length standard. This has been increasingly mirrored in the different assessments of arm's length related case-law around the world (and in Europe in particular).

Hence, these different standards of application of the arm's length lead, naturally, to the existence of different arm's length standards not only in *time*, as described above, but also coexisting in *space*. Against this background, and minding the considerations which will follow, the *research question* we seek to respond, as well as our *aims and objectives*, within the scope of this endeavour are detailed presented below.

### 1.1. Research Question

In essence, the research seeks to answer to the question:

- **How should the arm's length standard be reimagined to address the contemporary challenges to its core elements of rationale, results, compliance requirements, roles and coordination nature, minding the limitations imposed by a feasibility framework of implementation?**
  *Special attention is given to the reflexes of these challenges and responses within the European Union, particularly through the lens of the case law of the Court of Justice and to the specific implementation mechanisms available, which is also reflected in the analysis carried out within the aims and objectives of this research.*

### 1.2. Aims and Objectives

To answer to our proposed research question, the **aims and objectives** below are considered.

15 European Commission. *Proposal for a Council Directive on Transfer Pricing Rules and on a Common Framework for Transfer Pricing in the European Union.* COM (2023) 529 final, 12 September 2023. Aimed at addressing the challenges (and consequences) of the mismatches and interplays arising from the existence of different understandings/interpretations of the arm's length in the different Member States. For an overview, *see*: Raffaele Petruzzi and Argyro Myzithra. "The EC's Proposal for a Directive on Transfer Pricing: Paving the Road for a Common Application of the Arm's Length Principle." *International Transfer Pricing Journal* 31, no. 1 (2024).

16 European Commission. *Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT).* COM(2023) 532 final, 12 September 2023.

i. Determine the contours of the *feasibility framework* of implementation and of the arm's length *core* (i.e., rationale, results, compliance requirements, roles and coordination nature), streaming from the arm's length *time* and *space* evolution.

Based on the *time* and *space* variants and on the directions to which the elasticity of the arm's length has been tested and on the perceived arm's length, a common *core* of the arm's length standard should be drawn, under **Chapter 2** of the research, which will serve as the backbone for the considerations to be made further along the studies. The drawn *core* will focus on the elements of rationale, result, roles, compliance requirements and coordination nature.

From a political perspective, as briefly introduced, the maintenance of a certain arm's length standard was (and still *is*) considered as a desirable (or, let's rather say - *feasible*) premise to debate and accommodate the perceived necessary changes to the regulation of the associated party transactions' challenges to an effective corporate income tax application in an international and, especially, an EU context. Hence, under our drawn *feasibility framework*, any changes to the challenges to be further discussed must be accommodated within the identified arm's length core or contours.

Finding the contours to the arm's length standard is not, in itself, a novel work and other tax scholars have largely contributed to said endeavour[17]. Nevertheless, the fast-paced developments in the recent years raise the necessity for international tax law scholars and operators to thoroughly retake this endeavour, now significantly more complex, and delicate, than ever before.

ii. Assess what are the main *challenges* to each of the identified elements of the arm's length core, how they undermine an effective taxation of profits derived from associated parties' transactions and justify the need for a reimagination process of the arm's length standard.

The challenges to an effective income taxation of MNE (under associated parties' dynamics) have never been so evident and *pressing*. This statement also holds true in the European Union, due to a set of particularities and underlying effects perceived therein, notedly connected to the barriers to the exercise of the fundamental freedoms and the prohibition of (fiscal) State aid, risking that measures aimed at allocating profits for corporate income tax purpose to be considered non-compatible with the Treaty on the Functioning of the European Union[18] (**"TFEU"**) and EU Law in general.

The research will discuss what are, in the author's view, the biggest challenges to the arm's length standard's application which is believed to substantiate this *urgent* need of reimagination of the arm's length standard. The challenges presented will be

17 Especially R. Avi Yonah (even though usually from an American legal evolution perspective). Beyond the work Op. Cit. above *see*, as well: Avi-Yonah, Reuven S., and Ilan Benshalom**.** "Formulary Apportionment – Myths and Prospects: Promoting Better International Tax Policies by Utilizing the Misunderstood and Under-Theorized Formulary Alternative." *World Tax Journal* 3, no. 3 (2011).

18 European Union (EU). *Consolidated Version of the Treaty on the Functioning of the European Union.* Official Journal of the European Union, C 326, October 26, 2012: 47–390.

*intrinsically* linked to the above-identified elements to the drawn arm's length core (rationale, results, roles, compliance requirements and coordination nature).

**Chapter 3** of the research will, hence, address these main challenges to an *effective* application of an arm's length standard, from an international/general standpoint, and how these challenges are reflected in the EU, from the perspective of their possible effects on the compatibility of the (*current*) ALS with the TFEU.

Firstly, a foundational rationale of the arm's length standard *strictly* based along the lines of the separate entity approach has long led to inefficiencies in the standard's application, within a myriad of concrete cases[19]. The rapid evolution of the global business *rationale*, marked by the significant growth on the proportional scale of associated parties' transactions and their increased sophistication and integration severely undermines the ability of the ALS to account for economic realities, undermining comparability efforts[20]. Rational business decisions (or rather, *conducts*) are often disregarded by the *strict* entity approach and increasingly tight arm's length assessments seem to, now, compare the rule (associated-party transactions), with the exceptions (standalone, "independent", transactions).

In the EU, the efforts to maintain and impose the prevalence of a strictly entity approach ALS, not necessarily backed by current economic reality, is not rarely to be found into domestic Member States' transfer pricing legislations, which, in the author's view, are likely to fail the Court of Justice of the European Union (**"CJEU"**) tests of *proportionality* (to the *objectives* pursued), increasingly risking incompatibility with EU Law. This statement seems to be significantly underrated in current arm's length studies in the EU, especially after the recent CJEU cases, as *SGI*[21] and *Hornbach-Baumarkt*[22]. Hence, the challenges of compatibility of this strictly entity approach arm's length standard with the TFEU, and, especially, the *EU fundamental freedoms*, will be discussed, focusing on how current ALS has led to unjustified restrictions imposed by Member States, even in face of *valid commercial reasons* for taxpayers' profit allocation exercises.

Discussions around the enterprise approach alternatives to the entity approach were more strongly reintroduced to the international (and EU) tax *praxis*, beyond the CJEU case law, with the addition of the transactional methods and (on a much more

19 As in, e.g., Court of Justice of the European Union (CJEU), *Judgment of the Court (Grand Chamber) of 13 September 2018 – Hornbach-Baumarkt AG v. Finanzamt Landau (Case C-382/16)*, ECLI:EU:C:2018:705, and Court of Justice of the European Union (CJEU). *Judgment of the Court (Third Chamber) of 21 January 2010 – Société de Gestion Industrielle SA (SGI) v. État belge.* Case C-311/08, ECLI:EU:C:2010:26.

20 Schoueri, *op. cit.*, 3 ff.

21 CJEU, *Société de Gestion Industrielle (SGI) v. État belge*, Case C-311/08, ECLI:EU:C:2010:26.

22 CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau,* Case C-382/16, ECLI:EU:C:2018:705.

open fashion) with the OECD Pillar I Amount B, proposal[23]. The research will, henceforth, present the outlines of the enterprise approach alternatives (*hard* and *light* ones) and their eventual compatibility with the drawn arm's length core. These will then be used further ahead in the structure of the study.

The inefficiencies of this strict entity approach arm's length standard are also mirrored in the limitations encountered by the transfer pricing methods, based on the same entity *rationale*, centred in the challenges of the lack of *comparability*, responsible to ultimately undermine the arm's length *results*[24]. The research will discuss how the lack of comparability issue gradually contaminated the so-called traditional transfer pricing methods and their results and how this process led to the establishment of the new transactional net margin and profit split methods, as part of the attempt to reconquer the lost comparability by, in fact, *reimagining* it[25].

The research will bring forward an analysis on how these new (transactional) methods actually represented an embracement of the perceived failure of the traditional view of the arm's length comparability, how (*in a certain way*) the international community partially embraced an enterprise approach and how, passed now more than 30 years of its set in motion, the application of the new methods nurtured the dangerous phenomenon of *randomization* of the arm's length result, leading to an unprecedented level of lack of legal certainty in the international tax world and to a *Pandora Box* of compatibility issues with the EU Law, both in terms of the fundamental freedoms, with a lack of *objective* and *verifiable* criteria, and the prohibition of (fiscal) State aid.

Alternative solutions to the random results often obtained by the current application of the transfer pricing methods can be found under the auspices of *formulaic approaches* or *formulary apportionments* (from now on by us grouped under/interchangeably used in connection to the expression 'formula-based alternatives')[26]. Even though these are certainly not new to the transfer pricing and international tax debate (dating as far back as the subject in itself)[27] they have been strongly boosted with con-

23 Initially with: Organisation for Economic Co-operation and Development (OECD). *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*. OECD Publishing, Paris, 2020, culminating in: Organisation for Economic Co-operation and Development (OECD). *Pillar One – Amount B: Inclusive Framework on BEPS Progress Report*. Paris: OECD Publishing, 2024.

24 R. Collier and J. Andrus. *Transfer Pricing and the Arm's Length Principle after BEPS*. Oxford: Oxford University Press, 2017.

25 Louis Ballivet. "Use of Non-Arm's Length Approaches within the Arm's Length Principle: Heading towards a New Standard?" *International Transfer Pricing Journal* 27, no. 2 (2020).

26 Stefan Mayer. *Formulary Apportionment in the Internal Market*. IBFD Doctoral Series. Amsterdam: International Bureau of Fiscal Documentation (IBFD), 2009.

27 This evolution can be markedly found in the above cited Avi-Yonah bibliography, but also in, e.g.: Yariv Brauner. "Formula Based Transfer Pricing." *Intertax* 42, no. 10 (2014); Wolfgang Schön. "International Tax Coordination for a Second-Best World (Part III)." *World Tax Journal* 2, no. 3 (2010), among others.

temporary debates around, e.g., the mentioned Pillar I Amount B proposal[28]. At this point, the research will present the different views upon the formula-based alternatives (**"FBA"**) and analyse them based on our proposed *super hard*, *hard* and *light* categories. The understanding of the FBA and their evolution will be of utmost importance for the analysis to be carried out on further sections of this research.

Additionally, challenges related to the *compliance elements* will be addressed. The *undue administrative constraints* imposed to taxpayers (and tax administrations alike) not only nurture a significant deadweight loss in the economic operations of multinational businesses and significant additional public expenditure, but also might lead, in an EU context, to further incompatibilities with the TFEU, erecting yet another set of restrictions to the exercise of the fundamental freedoms[29]. Next to the perceived negative effects of the current application of more detailed transfer pricing methods, undue technical complexity has also contributed to most of the famous recent fiscal State aid cases in the CJEU, such as *Fiat*[30] and *Apple*[31], and at the level of the EGC, as in *Starbucks*[32].

Both existing compliance simplification safeguard mechanisms (e.g., documentation exemption thresholds) and enabling simplification safeguard mechanisms (i.e., conditions necessary for the implementation of a simplified or formula-based approach in specific ALS *space* variants) will be presented and will be brought back to the discussions ahead.

The argued *rationale* and *results* failure consequently lead to the perceived failure of current ALS to cope up with its theorized *roles*[33]. The research will, henceforth, demonstrate the challenges faced by the arm's length standard in the fulfilment of these roles and how they ultimately render the standard not only random, as per the above, but also strongly *inefficient*.

Next to the identified challenges, the semi-coordinated nature of the arm's length,

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28 As in, e.g.,: Gustavo Weiss de Resende. "Ahead of Its Time by Being Late? The Correlation between the Atypical Brazilian Transfer Pricing Rules and Amount B of the OECD Pillar One Proposal." *International Transfer Pricing Journal* 29, no. 5 (2022); Ian F. Dykes and Louise H. Keegan. "The OECD Pillar 1 Blueprint: Why Amount B Matters." *Bulletin for International Taxation* 75, no. 3 (2021); Francesco Saverio Scandone. "Let It (Amount) B." *International Transfer Pricing Journal* 30, no. 2 (2023).

29 As discussed, e.g., within Court of Justice of the European Union (CJEU). *Judgment of the Court (Third Chamber) of 21 January 2010 – Société de Gestion Industrielle SA (SGI) v. État belge*. Case C-311/08, ECLI:EU:C:2010:26.

30 Court of Justice of the European Union (CJEU). Judgment of the Court (Fourth Chamber) of 8 November 2022 – *Fiat Chrysler Finance Europe, Ireland, v. European Commission*. Joined Cases C-885/19 P and C-898/19 P, ECLI:EU:C:2022:859.

31 Court of Justice of the European Union (CJEU). Judgment of the Court (Grand Chamber) of 10 September 2024 – *European Commission v. Ireland and Others*. Case C-465/20, ECLI:EU:C:2024:724.

32 General Court (EGC), *Judgment of the General Court (Seventh Chamber, Extended Composition) of 24 September 2019 – Kingdom of the Netherlands v. European Commission (Case T-760/15); Starbucks Corp. and Starbucks Manufacturing Emea BV v. European Commission (Case T-636/16),* ECLI:EU:T:2019:661.

33 Pankiv, *op. cit.*

as to be described in the inaugural part of the research, poses additional relevant challenges to the standard's application or, rather, administration. Hence, the research will revisit the roots of this *coordination nature* and the different sets (and levels) of obstacles to a higher level of coordination in international and EU practices, also minding the identified arm's length space variants.

The consequences of the semi-coordinated level of current arm's length standard in terms of increased transfer pricing disputes, from a general perspective, and of barriers to the exercise of the fundamental freedoms, in the light of potential discriminatory restrictions, as well as of (fiscal) State aid, will be debated.

Minding the constructed feasibility framework, the processes of a stronger European coordination, under the idea of an EU arm's length *minimum standard*, will be presented, based on the contemporary discussions around the EC Transfer Pricing Directive proposal[34] and the EC and other EU institutions competencies to put forward said nature of alternatives[35]. As usual in the structure of this research, the outlines and understandings of these alternatives will be needed for the considerations lying ahead, especially around the implementation and compatibility discussions on the solutions to be proposed.

iii. Propose *changes* to the arm's length standard's application (reimagination process), propelled by and capable of addressing the negative effects of the analysed challenges, considering the limitations imposed by the *feasibility framework* of implementation.

Navigating from problems to potential solutions, **Chapter 4** of the research will propose the outlines of a *reimagined* arm's length standard, based on the construction of *three* main elements: the *Rational Business Conduct* (**"RBC"**) alternative, the *Formulaic-Approach Simplification Safeguard* (**"FASS"**) and the *Sequential Method Rule* (**"SMR"**). These would be aimed at tackling the challenges related to, respectively, the rationale, results, roles and compliance requirements elements of the arm's length core. The element of coordination nature would be tackled through the specific implementation framework of our proposed solution. Together, these tools should be able to reduce the negative effects of the identified challenges, minding the unavoidable restrictions imposed by the *feasibility framework*.

In the author's opinion, the inverted *rationale* logic now embedded in the arm's length standard (a *rule* compared to an *exception*) makes it a herculean task for its operators to establish an *approximate* arm's length *result*. Hence, as a first step, the proposed solution should try to soften this inversion by proposing the introduction of *light* enterprise approach elements to the arm's length *rationale*. These should be encapsulated within the idea of the RBC alternative and should contribute to broadening the accepted arm's length *commercial justifications*, thus also facilitating the passing of the CJEU's proportionality test.

Differently than some unsuccessful attempts to reimagine the arm's length standard

34 Petruzzi and Myzithra, *op. cit*.

35 As raised in, e.g.: Peter J. Wattel. "Starbucks and Fiat: Arm's Length Competition Law." *Intertax* 48, no. 1 (2020).

previously carried out, the proposed solution should have, as a priority, the much more attainable idea of significantly improving the legal certainty (in contrast with existing *randomization*) of the arm's length result, instead of trying to make it (excruciatingly more complex) "right". Categorically recognizing that said "right" result is practically impossible to be achieved would be a milestone in the international tax *praxis* - and, in the author's view, a very important one. Efforts and energies should, instead, be allocated towards reshaping the angles of the problem that can more readily be reshaped. The challenges faced by current arm's length methods will be confronted with the author's idea on a FASS and other *satellite* proposed adjustments to current methods will be described, aiming at conferring the *objective* and *verifiable* nature to the ALS, thus also better aligning it with the CJEU's view. Within the FASS discussions, thresholds of implementation will also be presented. They should be intrinsically related to the need to reduce the ALS undue administrative constraints, which we believe (may) cause significant issues in terms of the *necessity* assessment of the CJEU in Europe.

Finally, a SMR will be presented, as an *operative* rule ready to embody and govern the iterations not only between the proposed RBC and FASS, but also between those and existing transfer pricing methods. The research will describe how, without such joint (and coordinated) implementation of the RBC and the FASS, which are fundamentally different between them, the success of the proposed solution would be severely undermined.

Naturally, the *compatibility* of the reimagined ALS with the synthetized *core* and *feasibility framework*, drawn under Chapter 2, are of the utmost importance and will be thoroughly analysed. This research aims at having not only a sound theoretical backbone, but significant practical importance to current discussions, hence, compatibility will be analysed from multiple angles, i.e., with the established ALS core, OECD standard and its instruments and, additionally, with the EU fundamental freedoms and prohibition of (fiscal) State aid.

The suggested outlines of *implementation* of the proposed solutions will also be subject to the research endeavours. Here, although fit for a global scale of implementation, the research will focus on a believe more favourable first step EU-wide implementation.

This choice of *first step* is based not only on the perceived stronger (more pressing) reflexes of the ALS's challenges in the EU, when compared to a general/international perspective, but also because we believe that current level of integration (and underlying legal and political tools) available in the region can significantly favour the EU's pioneering in reimagining the arm's length standard.

If this (*political*) pioneering (or, even, protagonism) materializes, then the EU could be found in a leading role in the ALS evolution process - something typically carried by the US, as our time evolution assessment will demonstrate. If not, the regionally reimagined ALS would still be capable of, at least to a certain extent, soften the reflected negative effects of the identified general challenges, within the EU, likely also crystallizing an EU Law-compatible ALS variant, both from a fundamental freedom and from a (fiscal) State-aid perspective. These points will be further discussed within the *compatibility* analysis and implementation steps sections of Chapter 4.

Additionally, discussions around the EU competencies will be revisited and the roles of the different EU institutions in framing the proposed solution within a more integrated semi-coordinated EU arm's length minimum standard will be presented. Naturally, the foreseen iterations between the EU adopted solution and current OECD/international standard, if not jointly modified, will also be debated. Due care should be taken as to ensure that proposed implementation grounds do not negatively affect the compatibility analysis above indicated.

The author believes that if the EU first step does not evolve into a global solution, the changes will *not* be responsible for causing additional transfer pricing disputes, nor they seem capable of changing the semi-coordinated nature of the arm's length, globally speaking. Contrariwise, the research will put forward arguments to show how this first step, while not eliminating transfer pricing related disputes, the proposed solution can actually contribute significantly (within the EU) and moderately (in EU - non-EU situations) to *reduce* said disputes. Reduced compliance burden should also be expected with the proposed solutions and will be discussed by the research under the end of its Chapter 4.

All in all, walking the proposed path and addressing the elements highlighted above, the research aims at significantly contributing to the discussions around the pressing need for reimagination of the arm's length standard. As described under the negative delineation of the research topic below, the research is not invested in the pretentious idea of solving all the identified main challenges to the application of the arm's length standard. The author is, on the other hand, confident that the solidly analysed *feasibility framework* of implementation of the proposed changes - not only form a purely legal but, rather, multidisciplinary standpoint, will allow the research to provide the international tax community with efficient tools, ready to be implemented, to rapidly help *mitigating* important issues in the arm's length standard application.

### 1.3. Negative Delineation of the research topic

As described under the introduction to this research project, the changes to be proposed as answers to the formulated research question must be found under the drawn *feasibility framework*. The first premise to the *feasibility framework* is that associated parties' business will still be subject to corporate income taxes. It is noteworthy to highlight that some authors do propose solutions outside the incidence of corporate income taxes with theoretical background, for times, appealing. The analysis of these solutions will not be undertaken by the research.

Secondly, the research will not benchmark the proposed solutions against any sort of supra-national corporate income tax. Even though it is theoretically possible to have an international (or European) *unified* corporate income tax (e.g., under the auspices of some kind of *Global Tax Authority*), the research departs from the premise that such a leap from tax sovereignty is not possible under the *feasibility framework*.

Thirdly, the research will not propose solutions for an effective corporate income taxation of associated parties which would, *openly*, be at non-arm's length. This is not to say that the elasticity of the arm's length contours will not be tested/challenged. The negative delineation of the research topic, herein, is related to the tax policy influences on this legal research, as no solutions *openly* at non-arm's length are considered viable under the drawn *feasibility framework*.

Moreover, the research is not aimed at providing for a *perfect* solution, i.e., it is not under the scope of the research to provide for a comprehensive and definitive solution to the challenges analysed. This is valid from both a theoretical and practical standpoint. It is a premise of this research that such a solution either does not exist or would require such a level of compromise from its operators that would not be feasibly implementable in the short to mid-term perspective.

Hence, the success of the research endeavours should be analysed based on whether or not the research will be able to provide solutions which, in comparison to the current scenario, give better tools with which to minimize - *some of* - the negative effects of the analysed challenges.

Last but not least, the expected *tax effects* of the changes/reimaginations to be proposed within the research will be analysed solely from the perspective of *corporate income taxes*. Even though understanding the intrinsic relations between the different types of taxes incident in the business operations of associated parties, these consequences (e.g., in terms of value-added taxes) will be left for an eventual subsequent study.

## 1.4. Methodology

The research will be conducted based on the application of a document/legislation and literature review methodology, aligned with a historic, comparative and multidisciplinary analysis, all of which targeting a strong theoretical background, while aiming for the presentation of *feasible* practical results.

A historic methodology should be strongly applied under Chapter 2, especially to set the parameters for the understanding of the *time* variants of the arm's length standard. This methodology will also be applied in Chapter 3, to contribute to the understanding of the analysed challenges to an effective corporate income taxation of associated parties, especially in terms of the understanding of the evolution of the importance of corporate groups for the global economy as for the emergence of the tax challenges of the digital and global economy and the respective policy responses throughout the last decades.

The comparative method of study will also be used under Chapter 2, especially while analysing the *space* variants of the arm's length standard and will be reflected in the selection of documents and literature from different jurisdictions/backgrounds. The comparative method will also be used under Chapter 3, but mostly under Chapter 4, where comparisons should be made between current practice/solutions and proposed changes, in order to test/forecast their efficiency.

Additionally, the multidisciplinary approach should permeate all the work to be carried under the research. Even though the research is undertaken as a legal academic effort and focused therein, taxes are eminently multidisciplinary and completely setting aside the underlying connections with tax policy, economics, business, etc., as well as with other fields of law, e.g., administrative, corporate, philosophy, etc. would inevitably render the research results fragile.

The use of such methodologies should contribute to the presentation of a practical, feasible solution, related to the research result and to its objectives, capable of been implemented both because of its strong theoretical foundations, with the use of the most relevant sources available globally, but also with the account for the political and administrative circumstances of its implementation, both from a public standpoint and from the optical of MNEs, as taxpayers.

## 1.5. Defended Statement

The central argument defended in this doctoral dissertation in Law is that current OECD arm's length *variant* is *uncapable* of efficiently addressing the contemporary challenges inflicting the different elements to the arm's length core. Without a reimagination process, which would be able to be readily implemented within the arm's length *praxis*, the international community risks undermining the efficiency of the corporate taxation of MNEs, leading not only to potential significant loss of tax revenues (or a *misallocation* thereof), but also to the erecting of barriers to the international growth of the economy, directly affecting these same MNEs.

Although many were the solutions proposed for what we now call the *reimagination* process, we believe that a comprehensive, balancing the inexorable elements of legal theory and policy, accounting for the fast-paced developments around the subject in recent years was not yet presented to the international community. We are confident that this study will contribute to the (*start* of the) fulfilment of this gap, setting grounds for a structured, strongly theory-based, politically feasible, historically coherent, discussion around the improvements necessary to the ALS and, consequently, to an effective taxation of the profits derived from the activities of MNEs.

# CHAPTER 2. THE ARM'S LENGTH STANDARD

## 2.1. The Arm's Length Standard in *Time*

Our journey begins with the growing internationalization of the economy and the overall raise in corporate income tax rates, following World War I[36], which led to an increased concern around the excessive tax burden (or, *liability*) suffered by businesses operating abroad and around the issue of double taxation. This phenomenon existed as both the country of residence and the jurisdiction under which income was deemed to have arisen (or be *sourced*) were to impose their taxing powers upon that business/taxpayer[37].

Even prior to the War, in Europe, early mechanisms were already (yet *timidly*) set in motion to tackle the early identified double-taxation issue, resorting to *bilateral* conventions, or treaties. The first mechanism of such a kind is commonly referred in the literature to be the treaty concluded between Prussia and the Austro-Hungarian Empire, in 1899[38], although others proliferated by the period shortly *after* the War[39]. These treaties incorporated instruments which foreseen mutual *concessions* (between the country of residence and the country where the income was deemed to arise, or to be sourced) to prevent the double-taxation arising from the joint levying of taxes on income or property[40].

The bilateral solution was, nevertheless, not promptly adopted outside of Europe.

The United States, from 1918 to the mid-1920's, resorted, mostly, to a *unilateral* double-taxation relief mechanism for its resident taxpayers, under the 1918 Revenue Act, allowing for a credit, upon the taxes due in the United States, corresponding to the foreign paid taxes[41].

At that point in time, the international community's early efforts in dealing with the emerging double-taxation challenge were, hence, markedly *uncoordinated*.

The United States Treasury, nevertheless, did not take long to realize the significant reduction on its domestic taxable basis (as foreign tax credits were often enough to offset the tax liability in the United States), even after the imposition of a series of limits to

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36 Reuven S. Avi-Yonah, "All of a Piece Throughout: The Four Ages of U.S. International Taxation", *Virginia Tax Review* 25, no. 2 (2005): 322.

37 Mitchell B. Carroll, "International Tax Law: Benefits for American Investors and Enterprises Abroad", *International Lawyer* 2, no. 4 (1968): 692.

38 As mentioned, e.g., in: Reuven S. Avi-Yonah and Eran Lempert, "The Historical Origins of the Multilateral Tax Convention", *Law & Economics Working Papers* (University of Michigan Law School Scholarship Repository, 2023): 8-9.

39 *Ibid.*, 9.

40 *Ibid.*, 7 ff.

41 National Bank of Commerce in New York, Federal Revenue Act of 1918: Complete Text with Reference Notes, Tables and Index (New York: National Bank of Commerce, February 1919), § 222, https://dn790005.ca.archive.org/0/items/federalrevenueac00bank/federalrevenueac00bank.pdf., accessed 22.05.2025.

the credits, already in 1921[42]. Hence, the United States started to adhere to the bilateral strategy, as a way to deal with the double-taxation issue, while assuring mutual *concessions* from its trading partners and increasing its foreign tax credits' efficiency.

In this context, the then recently established League of Nations commanded a study on the main aspects, or situations, leading to the arising international double-taxation. The *Report on Double Taxation* (1923), submitted to the League of Nations' Financial Committee by Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp[43] (**"Four Economists Report"**)[44], responding to that command, represented the first time that an international organization was actually set in the position of a main player or, at least, a main *forum* of discussion, in matters of international taxation[45]. This, as will be discussed below, led the way to the attempt on finding common and, allegedly, efficient ways to deal with the double-taxation issue by the international community.

### *2.1.1. The Four Economists Report*

The Four Economists Report[46] was a pivotal document addressing the issue of double taxation in an international context, further examining its economic consequences and, mostly, exploring potential *remedies* or *ways* towards these remedies.

The Four Economists Report's considerations were based on the *ability to pay* principle, which supports the levying of taxes based on the taxpayers' economic capacity, asserting that wealthier taxpayers should contribute more to the public revenue[47]. Introducing the concept of *economic allegiance*, the Four Economists Report identified key components that established a taxpayer's connection to a jurisdiction, thereby justifying that jurisdiction's right to tax. These components - production, possession, disposition of wealth, and enforceability of rights[48] - can be directly linked to our current notions of *residence* and *source*. A jurisdiction would have the right to tax either because it is the taxpayer's *residence*, where wealth is controlled or consumed, or because it is the *source* of the wealth, where income is generated or produced. This connection reflects the jurisdiction's role in contributing to the taxpayer's wealth and, by

42 Reuven S. Avi-Yonah, "All of a Piece Throughout: The Four Ages of U.S. International Taxation", *op. cit.*, 321.

43 League of Nations. *Report on Double Taxation Presented to the Financial Committee by Bruins, Einaudi, Seligman, and Sir Josiah Stamp*. League of Nations Document EFS 73. F. 19. Economic and Financial Commission, 1923.

44 *Ibid*.

45 As also noted by Avi-Yonah in: Reuven S. Avi-Yonah and Eran Lempert, "The Historical Origins of the Multilateral Tax Convention," *op. cit.*, 2.

46 League of Nations. *Report on Double Taxation Presented to the Financial Committee by Bruins, Einaudi, Seligman, and Sir Josiah Stamp*. *op. cit.*

47 Also, on the influences of the ability to pay principle in transfer pricing, *see*: Luís Eduardo Schoueri, "Arm's Length: Beyond the Guidelines of the OECD," *Bulletin for International Taxation* 65, no. 12 (2015).

48 League of Nations. *Report on Double Taxation Submitted to the Financial Committee*, *op. cit*.

extension, to their *ability to pay*[49].

Nevertheless, when income is earned across multiple jurisdictions (e.g., a *resident* of one country earning income in another, at *source*), determining the *actual* ability to pay might become complicated as such cases often lead to multiple jurisdictions attempting to tax the *same* portion of income, thus resulting in double-taxation and in a distortion of the principle.

The report strongly supported the preference towards *international* remedies for the issues highlighted with a *multilateral* mechanism/convention[50] as a "final goal". The same report recommended, nonetheless, that the rising bilateral structure (or *compromise*) had to be nurtured and strengthened until a multilateral instrument would indeed become feasible[51], although, this "final goal" was shortly abandoned and has only recently made its comeback, as we will further discuss.

Minding the *economic allegiance* idea, the report presented four primary alternatives as remedies to the double-taxation issue, within the compromise framework, the first two being the *deduction* and the *exemption* methods.

The *deduction method*, similar to the credit system under the USA 1918 Revenue Act, would simply allow for a credit upon the domestic tax liabilities, relative to the taxes paid abroad[52]. The *exemption method*, conversely, foresaw the exemption of all foreign income from domestic taxation. These methods gave rise to the methods to relieve double taxation, under Art.23A and 23B of the current 2017 version of the OECD Model Tax Convention on Income and on Capital (**"OECD Model Tax Convention"**)[53].

Naturally, by themselves, these methods would not be able to solve the problem for cases involving *integrated activities* (as in *permanent establishment* set-ups at that point in time and for *associated enterprises*, which would later on become increasingly relevant). Countries were still unable to agree on common grounds for determining the *tax base* for the taxes paid in foreign jurisdictions (deduction method) and the *foreign income* subject to exemption (exemption method) when income had more than one source (e.g., as with permanent establishment cases). This would inevitably lead to reliance on each country's domestic rules for assessing these elements and to eventual mismatches/disagreements, which could still result in double taxation.

The third proposed method was referred to as the *division of tax*, which ought to allocate taxing rights between the source and residence countries based on each country's contribution to wealth creation. It would distribute taxes through agreed-upon principles, to be included in the respective bilateral treaties, ensuring that the tax

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49 League of Nations. *Report on Double Taxation Submitted to the Financial Committee*, *op. cit*.

50 *Ibid.*

51 Reuven S. Avi-Yonah and Eran Lempert, *op. cit*.

52 League of Nations. *Report on Double Taxation Submitted to the Financial Committee*, *op. cit*.

53 Organisation for Economic Co-operation and Development (OECD). *Model Tax Convention on Income and on Capital: Condensed Version 2017*. OECD Publications, Paris, 2017.

liabilities in each State would be aligned with economic activities[54], once again reflecting the economic allegiance theory. Possible principles (*criteria*, *factors*) mentioned by the Four Economists Report were value of sales, capital employed, real estate or property values maintained, wages and salaries paid, and credits and stocks maintained within each jurisdiction[55].

Even though this method would overcome the first and second methods' difficulties in determining the profits attributable to each contracting State in cases of incomes with more than one source, it would create an *ex-ante* challenge: the *agreement* on the principles (and their respective *weights*) comprising the division of taxes, even if circumvented to a specific bilateral treaty and to two contracting States.

The division of tax method outlined in the Four Economists Report can be viewed as an early precursor of the idea of an *enterprise approach*, preaching the treatment of the profits of an overall business as of a single unit, regardless of whether the income is generated at the level of the parent company, a permanent establishment, or subsidiaries in different jurisdictions.

Under this framework, the profits are apportioned for tax purposes based on criteria that reflect the business' economic allegiance to the countries involved, whether the residence or source country. Hence, the method of the division of tax also laid the foundations for what would be referred to as *fractional apportionment* and, later, *formulaic approaches* in international taxation, although neither these expressions, nor the word "formula" (or equivalents) is yet to be found in the Four Economists Report.

Finally, the fourth proposed method, *classification and assignment*, preached that different types of income or wealth ought to be classified and the taxing rights upon these different types/categories of income or wealth were to be assigned to either the source or the residence country. Although this approach was deemed to allow for tailored solutions, it was also acknowledged that it would be more administratively burdensome[56].

According to the Four Economists Report, the classification and assignment method would be particularly valuable in cases related to the allocation of profits at different stages of economic operations, including situations where products are distributed out of the source countries[57]. For example, it recognizes that a source country might tax profits at the point of distribution (e.g., when goods leave the country) rather than waiting for the final sales to consumers in another jurisdiction, suggesting that source countries are entitled to tax profits based on their contribution to the production and distribution of goods[58], to the wealth generated therein and, ultimately, to their economic allegiance.

54 League of Nations. *Report on Double Taxation Submitted to the Financial Committee*. *op. cit*.

55 *Ibid.*

56 *Ibid.*

57 *Ibid.*

58 As described in: Mitchell B. Carroll, "International Tax Law: Benefits for American Investors and Enterprises Abroad", *op. cit.*, 697.

In cases as such, the same issues identified within the first and second methods would, nonetheless, persist, as there were no common bases determining how profit would be allocated to the source states in the, e.g., production and distribution of goods.

While the first and second methods gave rise to the methods to relieve double taxation, under the OECD Model Tax Convention[59], as mentioned, the fourth method still today dictates the structure of this same document, as one can readily perceive when analysing the way articles are structured therein, especially from Art.6 to 21[60]. The third method was never completely discarded, but its adoption in subsequent development of international tax law was not as straightforward, as we will gradually present throughout this study.

Even though the Four Economists Report failed in kick starting a *per se* multilateralism in international taxation, it did succeed in setting the basis for the first model tax convention (**"1928 Model"**)[61]. The 1928 Model was responsible for introducing key elements of the Four Economists Report to the bilateral treaties and to the emerging international tax law, such as the notion of *economic allegiance* and the methods for distribution of taxing rights, minding the ability to pay principle[62]. These are substantially mirrored in today's OECD Model Tax Convention structure, as thoroughly mentioned above[63].

Although the 1928 Model, based on the Four Economists Report, addressed methods for allocating taxing rights between the residence and source States, a significant challenge remained, nevertheless, unaddressed - the choice of a common basis upon which to allocate the adequate portion of profits to be attributable to the source and the residence States in a permanent establishment situation, hence following under one or another's taxing rights.

The 1928 Model (within its Art. 5[64]) simply relied on the competent administrations of the contracting States to agree on an allocation basis. The commentaries to the 1928 Model listed several *potential* methods for apportionment, such as capital involved, number of workers, wages, and receipts, acknowledging that these criteria would necessarily vary depending on the case[65].

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59 Mirrored, today, in: OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017. op. cit.*, Art. 23A and 23B.

60 *Ibid.*, Art. 6-21.

61 League of Nations. *Report on Double Taxation Submitted to the Financial Committee: Model Tax Conventions on Double Taxation and Allocation of Profits*. Geneva: League of Nations, 1928.

62 *Ibid.*

63 Organisation for Economic Co-operation and Development (OECD). *Model Tax Convention on Income and on Capital: Condensed Version 2017. op. cit.*

64 League of Nations. *Report on Double Taxation Submitted to the Financial Committee: Model Tax Conventions on Double Taxation and Allocation of Profits. op. cit.*, Article 5.

65 *Ibid*. See, also: David L.P. Francescucci. "The Arm's Length Principle and Group Dynamics – Part 1: The Conceptual Shortcomings." *International Transfer Pricing Journal* 11, no. 2 (March/April 2004): 62-63.

Only in 1933, following the work presented at the report on *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*[66] (**"Carroll Report"**), the League of Nations more substantially worked on the *profit-allocation methods*, which, as we will see, would serve as a basis for the arm's length standards known today.

### *2.1.2. The Carroll Report*

Shortly after the publishing of the 1928 Model, the League of Nations appointed a committee, initially led by Professor Thomas Sewell Adams[67], and, later on, by Mitchell B. Carroll, both related to the US Treasury, to evaluate which methods (or *basis*) were *already* in use by States to allocate profits from international/inter-states relations, which could be incorporated in the developing bilateral structure of international taxation and on the recently published Art.5 of the 1928 Model. The results of the studies conducted were presented in 1933, on what came to be known as the *Carroll Report*.

As it turned out, the Carroll Report corroborated that no problems usually arose in allocating certain types of income to their "source State", when such type of income could be traced to a single source (e.g., *interest* and *royalty* incomes, among others)[68]. Notedly, these were set to become *significantly* problematic with the advent of the spread of multinational corporate groups and the underlying tax avoidance schemes a few years later[69].

At that time, though, the main concern was not with the adequateness of the pricing of the *interest* and *royalties*, as per the above examples. Standalone entities were still the *rule* in the 1930's economic landscape and, hence, the prices (and underlying profit allocation) between the parties were naturally *non-artificial* and did not pose significant tax scrutiny.

The main problem was, alternatively, identified when products were *produced* in one country, but *sold* in another (through, e.g., a permanent establishment), as also identified by the Four Economists Report. Hence, as later highlighted by Schoueri, the allocation problem was initially focused on branches, instead of subsidiaries[70]. This

66 Mitchell B. Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, League of Nations, Geneva, 1933.The Report is commonly referred to in the literature as the Carroll Report given the prominence of the member of the US treasury in its elaboration.

67 For further details on the work of T.S. Adams, one of the first important names of US international taxation, *see*: Thomas Earl Geu. "Professor T.S. Adams (1873-1933) on Federal Taxation: Deja Vu All Over Again." *Akron Tax Journal* 10 (1993): 29-45.

68 Carroll, "International Tax Law: Benefits for American Investors and Enterprises Abroad," *op. cit*., 704-705.

69 Giving raise, for example, to even specific sections in current OECD Transfer Pricing Guidelines: Organisation for Economic Co-operation and Development (OECD). *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*. Paris: OECD Publications, 2022.

70 Schoueri, *op. cit*., 692.

"segregation" between what Carroll called the incomes that could be allocated to a single source (as e.g., *interest* and *royalties*, but not only) and those which arose from multiple jurisdictions (mainly *business profits*) is somehow still reflected in today's OECD Model Tax Convention's structure[71], and reflects the still existing different tax treatments between *active* and *passive* income[72].

Several different domestic approaches in dealing with the problem of allocating income (within the 1928 Model Art. 5 context) were then analysed[73]. The approaches identified could be placed under three main categories, the *empirical* method, the *separate accounting* method, and the *fractional apportionment* method[74].

The *empirical* method allocates profits based on observable, tangible factors like physical presence, employees, wages, or assets within a country, benchmarking the income of the permanent establishment at source with the income of similar enterprises of the permanent establishment State[75]. This approach was used, for instance, in France and Germany[76].

Although the Caroll Report recognized the simplicity of this method, it also acknowledged that it might not reflect the full scope of a company's operations, particularly for more complex multinational businesses and might lead to *arbitrary* results[77].

The *separate accounting* method allocates profits by treating each branch or subsidiary as a distinct entity, relying on detailed financial records to attribute income and expenses accurately. This method, as we will further discuss, can be pointed out as the precursor of the *entity approach*, which has been a cornerstone of transfer pricing and international tax law[78], at least for the first several decades of their development. While precise, the method was recognized as complex[79] and an enormity of other complexi-

71 Organisation for Economic Co-operation and Development (OECD). *Model Tax Convention on Income and on Capital: Condensed Version 2017*, *op. cit*.

72 Avi-Yonah, "All of a Piece Throughout: The Four Ages of U.S. International Taxation," *op. cit*., 322.

73 Carroll, "International Tax Law: Benefits for American Investors and Enterprises Abroad," *op. cit*., 704.

74 Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, *op. cit*. Also discussed, e.g., in Mitchell B. Carroll, "International Tax Law: Benefits for American Investors and Enterprises Abroad *op. cit*., Francescucci, "*op. cit*., 63-64.

75 Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, *op. cit*. Francescucci, *op. cit*., 63.

76 Carroll, "International Tax Law: Benefits for American Investors and Enterprises Abroad," *op. cit*., 705.

77 Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, *op. cit*.

78 As also referred to by: Schoueri, *op. cit*., 692 and Vikram Chand, Alessandro Turina and Louis Ballivet, "Profit Allocation within MNEs in Light of the Ongoing Digital Debate on Pillar I – A "2020 Compromise"? From Using a Facts and Circumstances Analysis or Allocation Keys to Predetermined Allocation Approaches", *World Tax Journal*, 12, 3 (2020), 567-568.

79 Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, *op. cit*.

ties were to be identified in the years following the Carroll Report.

This method was adopted by the United Kingdom, but also by several US States, where the detailing of the rules was considered as the most advanced ones by the Carroll Report[80].

Finally, the *fractional apportionment* method uses a formula, typically based on factors like sales, payroll, and property, to proportionally divide profits among jurisdictions. Although it was recognized that this method, as used by Spain and US States such as Massachusetts, New York and Wisconsin, offered a simpler approach to the problem, it was also acknowledged that it could lead to an arbitrary approach for taxing integrated operations[81]. This category very much resembles the *division of tax* method, as presented by the Four Economists Report a few years earlier.

The Carroll Report criticized the *fractional apportionment* method for several reasons. Firstly, it was stated that it could lead to *arbitrary* results, as different countries might prioritize different factors (e.g., sales, payroll, or property) in the formula, making it difficult to reach an international consensus on a uniform apportionment approach. The Carroll Report also pointed out that formulary apportionment *lacked precision* in reflecting the actual economic contribution of each jurisdiction to the overall profits of a multinational enterprise. Finally, the Carroll Report emphasized that such formulas might oversimplify complex business operations, particularly when integrated activities span multiple jurisdictions, which could distort the allocation of profits and lead to unfair taxation[82].

The Carroll Report concluded that none of the three methods (i.e., *empirical*, *separate accounting*, or *fractional apportionment*) offered a perfect solution for the profit allocation problem. Although the Carroll Report displayed preference towards the *separate accounting* methods, it actually neither discarded the *empirical* nor the *fractional apportionment* methods, contrary to what one might think[83].

The opinions embodied within the Carroll Report were of a decisive importance to the Article 5 of the League of Nations' 1933[84] and 1935[85] Model Drafts, which favoured the *separate accounting* method as the primary approach for allocating business profits

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80 Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, *op. cit*.

81 Carroll, "International Tax Law: Benefits for American Investors and Enterprises Abroad," *op. cit*., 705.

82 Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, *op. cit*.

83 Francescucci, *op. cit*., 64.

84 League of Nations. *Draft Convention Adopted for the Allocation of Business Income Between States for the Purpose of Taxation. op. cit*., Article 5.

85 League of Nations. *Draft Convention for the Allocation of Business Income Between States*. Document C.252.M.124.1935.IIA. Annex to Fiscal Committee Report of 1935. Geneva: League of Nations, 1935. This second was a mere *adaptation* from the first. The 1933 Draft was meant to substantiate a *multilateral* convention, while the second again recognized the previously raised non-feasibility of such an attempt and was adapted to serve the purpose of being a *bilateral* model convention instead. Francescucci, "*op. cit*., 63-64.

to permanent establishments. However, in cases where separate accounts were not available or inadequate, the *fractional apportionment* method was suggested as a fall-back, allowing countries to negotiate a basis for apportionment based on factors like sales, payroll, or capital[86].

Article 5 of the League of Nations' 1933[87] and 1935[88] Model Drafts served as the early foundations for Article 9(1) of the 2017 OECD Model Convention, seen as their contemporary 'equivalent'[89]. This helps to substantiate the idea, as further sections of this study will discuss, that the arm's length standard, today, is based on notions drafted for the context of a 'brick and mortar' economy of the 1930's.

Moreover, the developments of the 1928 Model and the 1933 Carroll Report also help to substantiate our understanding that the arm's length standard, which would soon emerge from the *separate accounting* methods, embodied in the bilateral compromise framework of the then international tax law (i.e., the 1928 Model and the 1933 and 1935 Drafts), was born as an *allocation mechanism* (and not necessarily as an anti-avoidance instrument).

Although the 1935 Draft never actually became a model convention in itself, largely due to the outbreak of World War II, it served as an interpretational guidance to Art. 5 of the 1928 Model[90] until the drafting of the 1943 and 1946 models.

### *2.1.3. The League of Nations 1943 and 1946 Model Tax Conventions*

Following the publication of the Carroll Report and the 1933 Draft, the US implemented, in 1934, the separate accounting approach for the first time at a *federal* legislation level, within the then Section 45 of the Internal Revenue Act (current Section 482)[91]. Section 45 focused on the scrutiny of transactions between *commonly controlled* businesses, similar to what Article 9 of the 1943 Mexico and the 1946 London Models would do a few years later.

By allowing the Commissioner to distribute, apportion, or allocate income and deductions among such businesses, Section 45 aimed to ensure that the commonly controlled businesses reported profits that "clearly reflect the income of any of such

86 League of Nations. *Draft Convention for the Allocation of Business Income Between States*. Document C.252.M.124.1935.IIA. Annex to Fiscal Committee Report of 1935. *op. cit*. As also highlighted by Carroll, "International Tax Law: Benefits for American Investors and Enterprises Abroad," *op. cit*., 706-707 and Francescucci. *op. cit*., 63-64.

87 League of Nations. *Draft Convention Adopted for the Allocation of Business Income Between States for the Purpose of Taxation. op. cit*., Article 5.

88 League of Nations. *Draft Convention for the Allocation of Business Income Between States*. Document C.252.M.124.1935.IIA. Annex to Fiscal Committee Report of 1935. *op. cit*., Article 5.

89 As also noted by, e.g., Francescucci. *op. cit*. 64.

90 Also known as the 1935 Allocation Model. *Ibid*., 64.

91 United States. *Internal Revenue Act of 1934*, Section 45, as in Avi-Yonah. *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation. op. cit*., 5.

businesses" separately, individually, highlighting the need to treat related parties (including permanent establishments) as if they were independent and laying the groundwork for the *arm's length standard*. Notably, Section 45 also included a concern about preventing *tax evasion*, which was not so clearly stated in the mentioned League of Nations' Model[92], although the focus seems to have remained on the accurate income reflection[93].

The term arm's length was only first introduced in a national legislation a year after the publication of Section 45, through issued Regulations which mentioned, *in verbis*, that "(...) The standard to be applied in every case is that of an uncontrolled taxpayer dealing at *arm's length* with another uncontrolled taxpayer."[94]. Again, this term, while used for almost a decade prior to the 1943 Mexico Model, was neither adopted by it, nor by its London successor, in 1946.

As highlighted by authors like Avi-Yonah[95], Brauner[96] and Francescucci[97], although introducing the arm's length standard, Section 45 failed to provide for further guidance (i.e., *methods*) on how to achieve/verify the actual compliance with the arm's length[98]. This task remained as a work for the courts up until 1968, in the United States, and rather until later (1979) for most of the world's major economies.

The League of Nations, as such, still produced two other relevant models, namely the mentioned 1943 Mexico Model[99] and the 1946 London Model[100]. The reason underlying the elaboration of two Models in such a short time frame is alleged to be the circumstances of World War II, which lead the first model to be drafted mainly by Latin American States (capital-importing countries) with provisions favouring source taxation, while the 1946 version already counted on the active participation of capital

92 A concern only observed in the wording of their respective commentaries. League of Nations. *Model Bilateral Conventions for the Prevention of International Double Taxation and Fiscal Evasion*. Geneva: League of Nations, 1943: Commentaries to Article 9, and League of Nations. *Model Bilateral Convention for the Prevention of the Double Taxation of Income and Property*. Geneva: League of Nations, 1946: Commentaries to Article 9.

93 United States. Internal Revenue Act of 1934, Section 45, *op. cit*.

94 United States, Department of the Treasury. Regulations 86, under Section 45 of the Revenue Act of 1934, Art. 45-1(c) (1935).

95 Avi-Yonah. *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation. op. cit*., 4-5.

96 Yariv Brauner. "Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes." *Virginia Tax Review* 28, 79 (2008): 96.

97 Francescucci. *op. cit*., 63-64.

98 United States. Internal Revenue Act of 1934, Section 45, *op. cit*.

99 League of Nations. *Model Bilateral Conventions for the Prevention of International Double Taxation and Fiscal Evasion. op. cit*.

100 League of Nations. *Model Bilateral Convention for the Prevention of the Double Taxation of Income and Property. op. cit*.

exporting countries, leading to changes in favour of residence taxation.[101]

In any case, neither one of the last League of Nation's Models introduced significant changes to Article 5 of the 1933 Draft, although the Commentaries to the 1946 Model now briefly mentioned an objective to 'avoid abuses resulting in the diversion of profits or losses from one company to the other'[102]. The term 'arm's length' was still not in use, only the expression 'independent enterprises' could be read.

Following the dissolution of the League of Nations, in 1946 (shortly after the publication of the 1946 London Model), the international community saw the publication of the *draft* Convention on the Avoidance of Double Taxation, in 1955, by the Organisation for European Economic Co-operation (**"OEEC"**)[103] within the context of the US Marshal Plan and the need to foster European economic development. Finally, the first model tax convention elaborated by the Organization for Economic Cooperation and Development (**"OECD"**) was published in 1963[104]. While these did not introduce significant advances to the arm's length realm, the latter represented the first time that such a term was *expressly* adopted by a relevant international model tax convention[105].

### *2.1.4. The 1979 OECD Transfer Pricing Guidelines*

As we will discuss, the period between the publication of Section 45 (and the 1933 Draft, 1943 and 1946 League of Nations Models) and the introduction of the *traditional* transfer pricing methods, from 1968 or later, was marked by the application by the courts of the *fair and reasonable* or *best judgment* approaches.

A note to our reader - you may have noticed that we have not adopted the term *principle* while referring to the arm's length. We have opted to use the term *standard* instead. Apparently, the choice *not* to use the term principle was also followed by the 1935 legislator in the US, within Regulations 86 under Section 45 of the Internal Revenue Act. Given our established feasibility framework and our premise that any proposed solution *must* be at arm's length, the actual importance of determining whether or not the arm's length is a principle of law is significantly reduced and such effort is, therefore, not deemed necessary under the scope of this study.

The transfer pricing methods, providing ways to achieve/verify the arm's length nature of transactions carried out between associated parties were only introduced in

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101 Ash, Elliot and Marian, Omri. The Making of International Tax Law: Empirical Evidence from Natural Language Processing. *Legal Studies Research Paper Series*, School of Law, University of California Irvine, No. 2019-02, 2019, 10.

102 Commentary on the Model Bilateral Convention on the Prevention of Double Taxation of Income and Property in Ekkehart and Rust, eds., *op. cit.*, 598.

103 Organisation for European Economic Co-operation (OEEC), *Draft Convention on the Avoidance of Double Taxation*. 1955.

104 Organisation for Economic Co-operation and Development (OECD), *Model Tax Convention on Income and on Capital.* OECD Publications, Paris, 1963.

105 *Ibid.*, Commentaries to Article 9.

1968, in the US Internal Revenue Act[106].

In our view, the introduction of the comparable uncontrolled price (**"CUP"**), resale price (**"RP"**) and cost-plus (**"CP"**) methods institutionalized the resort to *stricter comparability* in the arm's length assessment process.

Prior to such institutionalization, early arm's length case law resorted to a panacea of reasoning in the application of the arm's length standard, in the absence of clearly established methods, without properly focusing on whether comparables existed, as also once highlighted by Avi-Yonah[107]. Stricter comparability, while not yet structured under *proper* methods, began to be used as one (within many) reasoning to sustain the arm's length nature of related parties' transactions, in parallel with others. *Hall* vs. *Commissioner*[108], in the US, for example, indicate the *rise*[109] of this comparability reasoning as a strong arm's length *verifier*.

The results obtained by the US Treasury in the cases following the implementation of the arm's length standard in federal legislation led to a growing fear of the uncertainties of the arm's length assessments by the courts, or even it's upholding as the only valid instance for verification of the "true income" of the parties (in the context of Section 45)[110]. This fear, combined with the perceived use of transfer pricing (and its broader reasonings) by US taxpayers to avoid US taxes trough transactions with foreign affiliates (usually set in tax havens) led to the 1968 Regulations and tightening of a comparability-based arm's length standard[111], in the search for a more *objective* and *enforceable* arm's length, at least as perceived by the US Treasury at that point.

We, further ahead, will expand on the analysis upon the evolution of the *role* of the arm's length standard over time. It is sufficient to highlight, herein, that the 1968 Regulations already demonstrated a much greater concern with issues around tax evasion (and, mostly, *avoidance*) and with the need to adequate the arm's length to work as an anti-avoidance instrument, beyond a mere profit-allocation standard.

Henceforth, the 1968 Regulations introduced *CUP*, *RP* and *CP* methods.

The *CUP* method was thought to be used primarily for transactions involving tangible goods, under which the *prices* charged in related-party transactions would be compared with prices verified in similar, uncontrolled transactions[112].

The *RP* method would be applicable to, as the name indicates, verify the arm's

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106 United States Treasury Department, *Treasury Regulations on Income Tax: Section 1.482-1 (1968).*

107 Avi-Yonah. *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation*, *op. cit.*, 5.

108 U.S. Tax Court, *Hall v. Commissioner*, 32 T.C. 390 (1959), aff'd, 294 F.2d 82 (5th Cir. 1961).

109 This is another reference to the phases of the arm's length evolution, as addressed by Avi-Yonah in one of his famous articles on US international taxation: Reuven S. Avi-Yonah. *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation. op. cit.*

110 Reuven S. Avi-Yonah. *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation. op. cit.*, 5.

111 *Ibid.*, 5.

112 United States Treasury Department, *Treasury Regulations on Income Tax: Section 1.482-2(e)(2).*

length nature of a resale transaction, by calculating *prices* by subtracting a gross profit margin (based on comparable uncontrolled sales) from the resale price to third parties[113].

Finally, the *CP* method would be applicable to both manufacturing and service activities. This method would rely on the verification of the arm's length price by adding an appropriate profit markup to the costs incurred by the supplier in the controlled transaction[114].

Despite the context of "enforcement" of the comparability exercise within the arm's length assessment, encapsulated within the methods above explained, only the CUP method can be understood as capable to undertake a proper *pure* comparability[115].

We believe that the early recognized insufficiency of the CUP method led to the concomitant establishment of both the RP and CP methods. At that time, at least within the context of the 1968 Regulations in the US, priority would have to be given to that *pure* comparability, which was translated into the primacy of the CUP method within a methods *hierarchy* in the arm's length assessment process[116]. This hierarchy, in our view, evidences the early understanding of the US Treasury that both the RP and the CP methods were not reflexes of a *pure* comparability assessment.

In line with our considerations on the perceived insufficiency of the comparability analysis (either in its *pure* or even in its RP/CP *broadened* versions), the 1968 Regulations, expressly recognized that, depending on the specificities of the cases, none of the three theorized methods would satisfactorily apply and, hence, the possibility of a *fourth method* was given[117]. This Chapter 2 will further delve into the reflections of this perception which we deem especially important for our understanding of the *core* of the arm's length standard.

As we will see, the *traditional* methods, contained in the 1968 Regulations, later reverberated in the arm's length assessment in an international/European scenario, markedly from the late 1970's to the early 1980's, especially propelled by the 1979 OECD Transfer Pricing and Multinational Enterprises (**"1979 OECD Transfer Pricing**

113 United States Treasury Department, *Treasury Regulations on Income Tax: Section 1.482-2(e)(4).*

114 United States Treasury Department, *Treasury Regulations on Income Tax: Section 1.482-2(e)(3).*

115 Avi-Yonah. *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation, op. cit.*, 2.

116 United States Treasury Department, *Treasury Regulations on Income Tax: Section 1.482-1 (1968).*

117 It is not clear whether, at that time, the *fourth method* could be seen as a permissible statement for the continuation of the usage of the fair and reasonable standard, if demonstrated that the comparability was not possible in the concrete case. United States Treasury Department, *Treasury Regulations on Income Tax: Section 1.482-1 (1968)*, *Ibid*.

**Guidelines"**[118]). As the 1968 Regulations came to shed a light in the application of the US arm's length standard, the 1979 OECD Transfer Pricing Guidelines came to provide the additional *operative* elements needed to the arm's length in a European and international scenario, based on the authoritative statement of Article 9 of the then already revised version of the 1963 OECD Model Tax Convention (published in 1977[119]).

### *2.1.5. The 1995 OECD Transfer Pricing Guidelines*

The methods presented in both the 1968 Regulations and the 1979 OECD Transfer Pricing Guidelines rapidly presented themselves to fall short on their capabilities to accommodate (emerging) more complex MNE operations and underlying related-party transactions' dynamics. Especially within the US case law, several situations reached the courts, which were left with the task to evaluate either the taxpayer's or the Treasury's use of the somehow discretionary "fourth method".

Already in 1979, in *Du Pont*, Judge Nichols reported that the Treasury (and, consequently, taxpayers and the courts) were too often left with having to opt/resort to a fourth method, given the practical inapplicability of the 1968 Regulations introduced methods, such as the *RP* method, in *Du Pont*[120]. Although, as highlighted by Avi-Yonah, this particular case represented a win for the US Treasury, based on its use of a profit split-like allocation, most of the subsequent arm's length related cases in the 1980's turned out negatively for the Treasury, left with little effective tools with which to argue against taxpayers applied fourth methods, as was the case with *Lilly*[121] and *Searle*[122].

The unsuccess of the US Treasury in assuring what it considered to be the proper allocation of taxable profits to the United States, based on the then current 1968 Regulations, was likely the factor which mostly influenced the changes introduced to the United States ALS *space variant*, leading to the publication of the landmark Treasury's

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118 Organisation for Economic Co-operation and Development (OECD). *Transfer Pricing and Multinational Enterprises*. Paris: OECD Publishing, 1979. Although this document is not officially called "Guidelines", as referred to us in the body of the text, we have opted to use this terminology. The 1979 document is perceived to be the precursor of the current 2022 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations; hence, to more clearly demonstrate this continuity (and underlying sense of evolution) we have deemed our choice of wording appropriate.

119 Organisation for Economic Co-operation and Development (OECD). *Model Double Taxation Convention on Income and Capital*. Paris: OECD Publishing, 1977.

120 United States Court of Claims, *United States v. E.I. Du Pont de Nemours & Co.*, 608 F.2d 445 (1979).

121 United States Tax Court, *Eli Lilly and Company and Subsidiaries v. Commissioner of Internal Revenue*, 84 T.C. 996 (1985).

122 United States Tax Court. *G.D. Searle Co. and Subsidiaries v. Commissioner of Internal Revenue*, 88 T.C. 252 (1987).

*Study of Intercompany Pricing* ("**1988 US White Paper**")[123], confirming the *fall* of the traditional arm's length standard[124] stamped within the 1994 Regulations[125].

The main (or, at least, a very significant) arm's length concern of the Treasury and the US government was around the inability of the Treasury to assure a "proper" allocation of taxable profits to the US companies within a MNE structure, especially when those profits were derived from *intangibles* - something that, since then, was starting to rapidly grow. Intangibles, by nature, are frequently unique and difficult to compare to third-party transactions, rendering standard arm's length methods, such as the CUP, RP and CP, inefficient. The increasing ability of MNEs to separate R&D activities and the income deriving from such was also at the centre of the concerns[126].

On the tail of these developments, the concern around the issue was such that initially proposed US changes were propagated as a *departure* from the ALS in itself, rapidly causing concerns with the US treaty partners, especially in Europe[127]. As stated in a known US document, the 'House Report on House Bill 3838':

> "Many observers have questioned the effectiveness of the "arm's length" approach of the regulations under Section 482. A recurrent problem is the absence of comparable arm's length transactions between unrelated parties, and the inconsistent results of attempting to impose an arm's length concept in the absence of comparables."[128]

This statement underscores a growing awareness that the interactions within an MNE might fundamentally differ from those between unrelated parties, challenging the very foundation of the then ALS. We will thoroughly come back to that point when discussing the insufficiency of a (*somehow still standing*) *strict* separate entity approach-based ALS, under Section 3.1. below.

In this context, the US Tax Reform Act of 1986 introduced the *Commensurate with Income* standard[129]. This new approach marked a departure from the *strict* reliance on finding comparable, as institutionalized with the 1968 Regulations methods, instead emphasizing on a broader framework for assessing economic substance. The *Commensurate with Income* allowed for periodic adjustments to transfer prices to account for changes in the profitability of intangibles, acknowledging that static comparable were insufficient for capturing the dynamic value of such assets. This shift reflected a

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123 Treasury Department Office of International Tax Counsel, Office of Tax Analysis, Internal Revenue Service, Office of Assistant Commissioner (International), Office of Associate Chief Counsel (International), *A Study of Intercompany Pricing*, Discussion Draft, October 18, 1988.

124 Avi-Yonah. *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation. op. cit.*, 15 ff.

125 United States Treasury Department, *Treasury Regulations on Income Tax: Section 1.482-1 (1994).*

126 Avi-Yonah. *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation. op. cit.*, 17.

127 *Ibid.,* 17 ff.

128 United States Congress, *Tax Reform Act of 1986*, H.R. 3838, 99th Congress, 1st Session, 1985.

129 *Ibid.*

loosening of traditional comparability standards, prioritizing the economic outcomes of transactions over *strict* transactional comparability.

Building on the narrower, *targeted to intangibles,* changes proposed in 1986, the 1988 White Paper further suggested broadening the scope of this new comparability standard to the *general* issue of lack of comparable, beyond the mere intangible-related examples, as captured by the Commensurate with Income approach. Accordingly, the 1988 White Paper proposed two *new* (yet case law inspired) transfer pricing methods, which would be based on a functional analysis of the parties' respective economic contributions, the Basic Arm's Length Return Method (**"BALRM"**) and the Profit Split Method (**"PSM"**), which would then be, to some extent, reflected the in US legislation in 1994[130]. These methods represented a significant evolution in the application of the ALS, relying heavily on income assessment and on functional analysis to allocate profits in a manner consistent with economic contributions rather than rigid transactional benchmarks[131].

The *BALRM*, as an evolution/built up from the previously discussed *Commensurate with Income* approach, was designed to test the *profitability* of routine entities, sought to evaluate whether the tested party earned an arm's length return on its activities by analysing its *functional profile*. This method emphasized simpler economic contributions, such as the performance of low-risk manufacturing or distribution activities, ensuring that the tested entity received a baseline return consistent with its limited risk and functional input.

Additionally, for cases under which the tested party would have a more complex economic background, with more complex functions, higher risks and the (more intense) use of self-developed intangibles, the Profit Split Method (**"PSM"**) would be applied. This method was based on the allocation of profits based on the relative contributions of the party to the overall value chain, employing a combination of market-based benchmarks for routine functions and residual profit allocation for unique contributions.

Both the BALRM and the PSM were rooted in the expanded use of functional analysis, a central theme of the 1988 White Paper, yet already present at the *Commensurate with Income* approach proposed earlier. Functional analysis aimed for a more nuanced understanding of the roles, risks, and assets of each party, thereby aiming to enable the allocation of profits even in the absence of exact comparables.

Despite these innovations, the 1988 White Paper was *very* careful to frame the BALRM and PSM as consistent with the ALS, reflecting the Treasury's sensitivity which followed from the House Report on House Bill 3838 concerns[132]. Given the potential backlash from treaty partners, particularly in Europe, the Treasury emphasized that these methods were indeed compatible with the ALS. This rhetorical adaptation,

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130 United States Treasury Department, *Treasury Regulations on Income Tax: Section 1.482-1 (1994), op. cit.*

131 Hubert Hamaekers, "Arm's Length – How Long?" *International Transfer Pricing Journal* 8, no. 2 (2001): 35.

132 United States Congress, *Tax Reform Act of 1986*, *op. cit.*

which, as we will shortly demonstrate, was followed by the OECD, is a milestone to our study and to our (to be constructed) ALS *core*. It not only significantly changed the notion of arm's length comparability, but it embodied a very strong political message, in the US and then, globally, that maintenance of *an* ALS was the way forward for the international (tax) community. This understanding will be key for our future considerations.

In the 1992 Proposed Regulations, the then theorized BALRM was replaced by the Comparable Profits Method (**"CPM"**)[133]. The latter, expanding on the solutions proposed by the BALRM, stretched even further the notion of comparability - in our opinion - allowing for a broader selection of comparable companies and for a comparison based on several (possible) financial ratios of *profitability*. The CPM, together with the PSM, were finally introduced in the 1994 Final Regulations[134], thus integrating Section 482.

Importantly, the 1994 Final Regulations have also established the Best Method Rule (**"BMR"**), in contrast with the previous hierarchy of the methods. The best method rule dictated that, in *verbis*:

> "In general. The arm's length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm's length result. Thus, there is no strict priority of methods, and no method will invariably be considered to be more reliable than others. An arm's length result may be determined under any method without establishing the inapplicability of another method, but if another method subsequently is shown to produce a more reliable measure of an arm's length result, such other method must be used. Similarly, if two or more applications of a single method provide inconsistent results, the arm's length result must be determined under the application that, under the facts and circumstances, provides the most reliable measure of an arm's length result."[135]

We shall come back to the BMR when discussing our proposed reimagined ALS, under Chapter 4 of this study.

Although the arm's length studies were led by the US developments, as probably already perceived by our reader, concerns around the subject and their underlying solutions, case law and legal literature in Europe (and around the world) experienced a significant growth ever since the introduction of the new methods, as European countries understood the growing need to preserve their own taxing rights or, rather, the portion of the profits' pie subject to these rights.

These *reactions* were firstly perceived from two angles.

Firstly, and given the fact that US regulations were tightening the scrutiny of US MNEs abroad and that such MNEs were mostly concerned in avoiding problems (i.e.,

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133 Avi-Yonah. *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation. op. cit.*, 20 ff.

134 United States Treasury Department, *Treasury Regulations on Income Tax: Section 1.482-1 (1994).* 2, c.

135 *Ibid.*

adjustments and fines) with the US Treasury, added pressure to European and International countries, as Canada and Japan[136], which quickly enabled changes in their domestic legislations, to accommodate for the same/similar new methods as contained in the US regulations and to aim at preserving local taxable profits.

On the other hand, and despite the mentioned political efforts made by the United States to fit the structural changes to Section 482 within a notion of arm's length, minding to preserve its treaty obligations with (European) counterparties and integration with current (long) standing international tax standards, the CPM and the PSM, as well as the underlying BMR, were not necessarily welcomed by *all* European countries, as highlighted by Prof. Hubert Hamaekers, who chaired the OECD's Working Party on Transfer Pricing and Multinational Enterprises and the Ad Hoc Group on Unitary Taxation in the 1980's[137]. In Germany, for example, changes to domestic transfer pricing regulations, in line with the changed scenario, were only made starting from the early 2000s, given the political pressure to internationally consolidate the then renewed ALS.

In this context, the 1995 OECD Transfer Pricing Guidelines[138] were published, introducing the profit-based methods, although naming the CPM as a Transactional Net Margin Method (**"TNMM"**), without bringing with it any significant technical changes. The 1995 OECD Transfer Pricing Guidelines, nevertheless, did not introduce the BMR[139] which, together with the still non-acceptance of the CPM/TNMM by important economies, such as the mentioned Germany, led to an increased risk of international double-taxation, only softened, at least from the coordination perspective, with the solidification of the newly introduced methods, which would be mirrored in the 2010 version of the OECD Transfer Pricing Guidelines[140].

For us, perhaps the most important message embodied within the 1995 OECD Transfer Pricing Guidelines is the international political will to adhere to a notion of *an* ALS. Following the changes introduced in the US, the international community had, perhaps, its most significant chance of rupture with the standard since the 1930's Carroll Report and, yet, opted to reshape the ALS contours, test the elasticity of its notion and reinforce the desire to have it as the international standard for the allocation of profits between associated-parties for corporate income tax purposes.

This understanding reads crystal clear in § 1.13 of the 1995 OECD Transfer Pricing

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136 As highlighted by Hubert Hamaekers *in*: Hamaekers, "Arm's Length – How Long?" *op. cit.*

137 Hamaekers, "Arm's Length – How Long?" *op. cit.*, 38.

138 Organisation for Economic Co-operation and Development (OECD). *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 1995. OECD Publications: Paris.

139 The 1995 OECD Transfer Pricing Guidelines adopted, instead, a less administratively burdensome approach, based on the choice of method that, for the case in hands, would better be able to reflect the arm's length nature of the transaction, as seen *in*: OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 1995. *op. cit.*, § 1.69.

140 Organisation for Economic Co-operation and Development, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2010. OECD Publications. Paris.

Guidelines, in *verbis*:

> "(...) [T]he view of OECD Member countries continues to be that the arm's length principle should govern the evaluation of transfer prices among associated enterprises. The arm's length principle is sound in theory since it provides the closest approximation of the workings of the open market in cases where goods and services are transferred between associated enterprises."[141]

Based on the increased protagonism of the international/OECD (and, markedly, Europe) in the arm's length development, especially from the 1990's, and on our goal to *boost* the European regional lead in the matter, from this moment on, whenever referring to arm's length related mechanisms, this study will use the OECD terminology (even when referring to a commonality with the US practice), unless otherwise explicitly mentioned.

### *2.1.6. The 2010 OECD Transfer Pricing Guidelines*

The 2010 OECD Transfer Pricing Guidelines were published at a time when the frameworks for *application* of the profit-based (or transactional) methods were not yet well-delineated.

Firstly, following what the US had quickly realize back in the 1990's, the 2010 version of the Guidelines acknowledged the increasing recurrence to the use of the profit-based methods, especially the TNMM[142], and opted to remove its still reigning - *theoretical* - hierarchy of methods, as presented in the previous 1995 version, which meant that the TNMM was no longer to be the last resort when it comes to the transfer pricing methods' choice. Hence, from 2010 onwards, the OECD expressly adopted a similar tool to the then criticized US BMR - the OECD's Most Appropriate Method[143] (**"MAM"**) was, therefore, a *rebranding* of the BMR, putting forward a softened wording, as well as less requirements/ administrative compliance burdens on the examination of each and every rejected method, as deemed present in the BMR US[144].

The MAM was presented by the OECD Transfer Pricing Guidelines in 2010, and its definition remained unchanged until current 2022 version of that same document. It is described therein as follows:

> "The selection of a transfer pricing method always aims at finding the most appropriate

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141 OECD. *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 1995. *op. cit.*, § 1.13.

142 As also highlighted by: Fris, Pim and Gonnet, Sébastien. "The State of the Art in Comparability for Transfer Pricing," *International Transfer Pricing Journal* 17, no. 2 (2010).

143 OECD. *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 1995. *op. cit.*, § 2.2.

144 Isabel Verlinden *et al.*, "OECD Publishes Revised Guidelines on Transfer Pricing, Accommodating 15 Years of Juggling the Arm's Length Principle in a Globalizing Business World," *International Transfer Pricing Journal* 17, no. 5 (2010): 336-337.

> 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; and 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. No one method is suitable in every possible situation, nor is it necessary to prove that a particular method is not suitable under the circumstances."[145]

Other noteworthy contributions of the 2010 OECD Transfer Pricing Guidelines were the revision to Chapter III, 'Comparability Analysis'[146] and, finally, the 'elevation of the status' of the PSM[147]. Still, its relevance is *significantly* less important than its 1995 equivalent, which is clearly exemplified by the significant difference in the number of academic articles published in respect of each of these versions. In the respective years of their publishing, *Intertax* featured *fifteen* articles discussing the 1995 updates, against *one* (indirectly discussing the matter) in 2010[148].

The OECD Transfer Pricing Guidelines would then be updated after the unfolding of the BEPS project and the publication of its Final Reports.

### *2.1.7. The BEPS Project*

In 2013, the OECD published its Report on 'Addressing Base Erosion and Profit Shifting'[149] (**"2013 Report"**), which comprehensively demonstrated the Organization's - and the international tax community's - concerns with the inability of tax systems, in general, to cope with the fast-paced changes to business *rationale* (new business *models*), globalization and digitalization of the economy. The earlier intangibles related problems of a couple of decades before was then, in 2013, significantly enlarged. Base erosion and profit shifting manoeuvres were increasingly understood to threaten the very maintenance/sustainability of tax revenues around the world and, ultimately, of

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145 OECD. *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2010. *op. cit.*, § 2.2., as well as in Organisation for Economic Co-operation and Development, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2022. OECD Publications: Paris: § 2.2.

146 OECD. *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2010. *op. cit.*, § 1.33 ff.

147 Verlinden et al., *op. cit.* OECD. *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2010 *op. cit.*, § 2.108 ff.

148 Count made using the *Intertax* issues' archive, available at < https://kluwerlawonline.com/Journals/Intertax/3 >, accessed on 9 December 2024.

149 Organisation for Economic Co-operation and Development (OECD), *Addressing Base Erosion and Profit Shifting*, OECD Publishing, Paris, 2013.

the sovereignty of countries. The questioning of the *fairness* of the current system was also raised by the 2013 Report, although somewhat still in a vague way[150].

Although the scope of the 2013 Report is fairly broad, it already highlights the then current transfer pricing dynamics, under the ALS, to be one of the elements mostly leading to BEPS[151]. The transactional methods introduced in the 1990's already demonstrated inefficiencies. Interestingly enough, the 2013 Report does not contain a single mention to the underlying ALS, in itself, possibly being the root of the identified challenges, as it does not indicate any movement towards the questioning of the standard, from an OECD perspective.

What the 2013 Report *does* is to demonstrate/resonate how quickly the 'new'/enlarged comparability standard, which we have extensively discussed above, was taken 'by granted' by the OECD. In this sense, please remind that such a 'new' standard was initially relegated to a secondary role by the same OECD, in 1995, and only in the 2010 revision of the Guidelines is that we have the increased focus on (i) comparability directly (or primarily) based on profits and on (ii) aligning remuneration - the *profits* - with the functional profile of the tested-party (functions, but also risks assumed and assets used). The 2013 Report already 'incorporates' this understanding as a *premise* of transfer pricing/ arm's length standard, in *verbis*:

> "One of the underlying assumptions of the arm's length principle is that the more extensive the functions/assets/risks of one party to the transaction, the greater its expected remuneration will be and *vice versa*."[152]

This, in our opinion, highlights the rather fast acceptance of the enlarged comparability standards brought by the profit-based methods, at least from 2010 onwards, which represents their complete - politically perceived - compatibility with an arm's length logic/*rationale*.

We will, naturally, focus on the arm's length/transfer pricing aspects of the OECD BEPS initiative which was, months later in 2013, structured in the form of an action plan built upon the foundations laid down by the 2013 Report above analysed[153]. Several are the comprehensive studies on the *other aspects* of the OECD BEPS 'world', but those will be out of our scope of analysis for this study[154].

The 2013 Action Plan on Base Erosion and Profit Shifting[155] (**"Action Plan"**) highlighted - or corroborated with - our above made comments on the OECD's perception of the relevance of transfer pricing or, rather, *mis*-pricing, and the then current ALS *variant* in allowing for BEPS, but also the Organization's firm view that the problems

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150 OECD, *Addressing Base Erosion and Profit Shifting*, *op. cit*.

151 *Ibid*., e.g., 6.

152 *Ibid*., 42.

153 *Ibid*.

154 For a comprehensive overview see (*in Portuguese language*): Ana Paula Dourado, *Governação Fiscal Global*, 2nd ed. (Coimbra, Portugal: Almedina, 2018).

155 OECD. *Action Plan on Base Erosion and Profit Shifting*, *op. cit*.

were not to be found on the standard in itself, but rather on its operationalization(s) (what we could call as its then current space *variant(s)*). The statements made in this paragraph can be easily agreed upon with the reading/analysis of Actions 8-10 of the Action Plan (out of its total of fifteen)[156].

The main point of BEPS Actions 8-10 was, therefore, to align transfer pricing outcomes with the vague notion of *value creation*, particularly in the context of intangibles, risk allocation and capital, which were deemed to more significantly contribute to BEPS. Perhaps the main influence of these Actions was the pursue of the idea of substance-over-form in transfer pricing, under which the economic substance would have to prevail over the contractual arrangements in a transfer pricing assessment - especially in face of those three mentioned spheres (i.e., intangibles, risk and capital).

Although the idea of substance-over-form might contribute, from one side, to the fulfilment of the strong anti-avoidance role of the ALS, reflected in the transfer pricing rules, it certainly opened the door to problems from another angle. Reinforced focus on the functional analysis - which, as we have highlighted, have already jumped high with the introduction, on an international level, of the transactional methods - brought by the development of the DEMPE (i.e., development, enhancement, maintenance, protection and exploitation) concept for intangibles, made the transfer pricing assessment way more *subjective*. This led to inconsistent transfer pricing assessments and to further distancing between the taxpayers and the tax authorities, thus increasing legal/tax uncertainties and, consequently, transfer pricing disputes[157].

Additionally, this assessment might differ from the (more benchmarkable) approach adopted by unrelated parties when pricing their transactions. It is important to note, as it will also be relevant for our considerations made in the paragraph below, that unrelated parties are more often than not bound by contractual terms, under a *pacta sunt servanda* logic.

Finally, the substance-over-form increased focus on functional analysis increased the possibilities of transfer pricing adjustments based on future/subsequent results. This, as our reader might remember, was already the case with the introduction, on an OECD level, of the TNMM, as this method rather evaluates the future consequences of controlled transactions - *profits* - to retroactively determine the ALS compliance. This was really exacerbated with the use of retroactive adjustments to the prices/profitability of hard-to-value intangible (**"HTVI"**) related transactions, not only within a single fiscal year, as with the TNMM, but also opening up a *Pandora Box* for a multi-year assessment/adjustment. More subjectivity, more legal/tax uncertainty.

In addition, the 2013 Report has also introduced the grounds for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and

156 OECD, *Action Plan on Base Erosion and Profit Shifting*, *op. cit*.

157 As we will further discuss below, transfer pricing disputes have significantly grown in the last decades, been a significant portion of these increased disputes related to intangibles. *Vide* our Chapter 3.

Profit Shifting (**"MLI"**)[158]. According to the mentioned 2013 Report, "interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution".[159] The MLI was further structured following the publication of the Final Report on BEPS Action 15[160] and is not an *operative* instrument[161], despite criticisms to its efficacy[162]. We will come back to the MLI when discussing the implementation options for our proposed reimagined ALS, under Chapter 4.

It is important to highlight, nonetheless, that the Action Plan clearly represented the third *landmark* moment in the arm's length history in which the international tax community had the more conditions to replace the standard and, yet, opted *not* to. Instead, the Action Plan served to restate the international political agreement around the ALS and to incorporate proposed (sometimes, *significant*) changes within the *core* of the ALS. From one side, this proves the growing elasticity of the ALS contours while, from another, demonstrates the strength of the mentioned political agreement. The *fourth moment* when this happened was within the BEPS 2.0 context, shortly after the publication of the mentioned 2015 Final Reports[163], following their inconclusiveness in terms of the (at least *operative*) future of the OECD ALS *variant*.

### *2.1.8. The BEPS 2.0*

The process known as the 'BEPS 2.0' can be deemed to have started from the establishment, in February 2016, of the OECD/G20 Inclusive Framework on BEPS[164]. Its creation was promoted by the OECD as a forum to allow for all interested jurisdictions (incl. non-OECD/G20 countries) to participate, on a supposedly *equal footing*, in both

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158 OECD, *Action Plan on Base Erosion and Profit Shifting*, *op. cit.*, 24.

159 *Ibid.*

160 Organisation for Economic Co-operation and Development (OECD), *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties: Action 15 – 2015 Final Report*. Paris: OECD Publications, 2015.

161 Organisation for Economic Co-operation and Development (OECD). *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*. Paris: OECD Publications, 2017.

162 *See*, e.g.: Johann Hattingh, "The Multilateral Instrument from a Legal Perspective: What May Be the Challenges?" *Bulletin for International Taxation* 71 (2017); Johann Hattingh, "The Impact of the BEPS Multilateral Instrument on International Tax Policies," *Bulletin for International Taxation* 72 (2018); and Aline Berbari, "The OECD/G20 Base Erosion and Profit Shifting (BEPS) Initiative and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS," *Bulletin for International Taxation* 71 (2017).

163 OECD, *Aligning Transfer Pricing Outcomes with Value Creation: Actions 8-10 - 2015 Final Reports*, *op. cit*.

164 *Vide*: Organisation for Economic Co-operation and Development (OECD). *Inclusive Framework on BEPS: Progress Report July 2016 – June 2017*. Paris: OECD Publications, 2017, 4.

the monitoring of the implementation of the BEPS measures which followed the 2015 Final Reports, as well as in the development of additional tools with which to tackle remaining BEPS challenges[165].

Although the BEPS 2.0 refers to a broad international tax process, as did the BEPS, we will focus exclusively on issues regarding the profit allocation/ALS realm. This segment of work can be initially framed as a follow-up from the inconclusiveness of the 2015 Final Report on BEPS Action 1, on the tax challenges of the digitalization of the economy, with a mandate being granted from the Inclusive Framework to the then established Task Force on the Digital Economy (**"TFDE"**), in January 2017[166].

Already in 2018, the TFDE/OECD published the OECD 2018 Interim Report on Tax Challenges Arising from Digitalisation[167] (**"2018 Interim Report"**), under which the Organization basically reinstated the inability of the 2015 BEPS Final Reports in proposing concrete solutions to the identified challenges arising from the digitalization of the economy, particularly in the context of aligning transfer pricing with *value creation*[168]. While BEPS Actions 8-10 did, in fact, introduce *targeted* measures to align transfer pricing rules with value creation, they were deemed not enough to address the growing BEPS concerns.

Although the 2018 Interim Report did not, in itself, propose a *concrete* roadmap forward, it set the basis for further work from the TFDE. Importantly, the 2018 Interim Report did not showcase any movement in the direction of contesting the ALS, showing due care in respecting the still perceived international community's desire to stick to an ALS, even coming from the - at least partially - failure of the 2015 Final Report on BEPS Action 1.

Following the publication of the 2018 Interim Report, several stakeholders' proposals proliferated, as indicated by the OECD[169], leading to the publication of the Policy Note on Addressing the Tax Challenges of the Digitalisation of the Economy[170] (**"2019 Policy Note"**). According to the 2019 Policy Note, the Organization would proceed with a self-called/proclaimed 'without prejudice basis's[171], ultimately meaning that proposals which would, in the 2019 Policy Note wording '(...) lead to solutions that go beyond the arm's length principle'[172] could be analysed. This somewhat different approach to the ALS was actually a novelty when compared to the wording/message we understood from the 2018 Interim Report, and we will come back to that

165 OECD, *Inclusive Framework on BEPS: Progress Report July 2016 – June 2017*, *op. cit.*, 1.

166 Organisation for Economic Co-operation and Development (OECD). *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*. Paris: OECD Publications, 2018, § 23.

167 *Ibid.*

168 *Ibid.*

169 OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy: Policy Note*, *op. cit.*

170 *Ibid.*

171 *Ibid.*, 1.

172 OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy: Policy Note*, *op. cit.*, 2.

consideration shortly ahead.

The 2019 Policy Note assessed that such proposals would be structured in *two pillars*[173]. The first pillar was meant to address challenges of profit allocation and nexus rules by focusing on capturing novel drivers of value creation in the digital economy (in what we could say to be a *renovated* way to capture the Four Economists Report's ability-to-pay). The second pillar, on the other hand, aimed at ensuring a minimum level of global taxation to address broader BEPS issues.

The reinstated concern in the 2019 Policy Note with the perceived need to "(...) allocate more taxing rights to market or user jurisdictions in situations where value is created by business activity through participation in the user or market jurisdiction that is not recognized in the framework for allocating profits"[174] shows the growing perception that the ALS (or, now, its eventual *replacement*) would have to carry the *role* of a strong *taxing rights redistribution mechanism*, as we have presented above.

A month later, in February 2019, the OECD then released the Public Consultation Document on Addressing the Tax Challenges of the Digitalisation of the Economy[175] (**"2019 Public Consultation"**). It is interesting to note, as its placement within the work of the TFDE indicates, that the 2019 Public Consultation was built around finding solutions to challenges of aligning value creation in a, as one can certainly say, *very limited* digital economy sector (e.g., social media platforms, ride-sharing services and cloud computing), even though the 2015 Final Report on BEPS Action 1 was keen on advertising for a non-ring fenced digital economy. As we will shortly demonstrate, this narrower scope was rapidly enlarged by the OECD, already in 2019.

Although the term "pillars" can already be found in the 2019 Public Consultation, as mentioned above, we will, from now on, only adopt this terminology when referring to the proposals drafted from the OECD's Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy[176] onwards, given that the structural changes made in the proposals following the 2019 Public Consultation reshaped these pillars.

The Sections below will provide an overview of the three main alternatives for addressing the profit allocation and nexus rules challenges, as put forward by the 2019 Public Consultation: the Significant Economic Presence (**"SEP"**), the User

173 OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy: Policy Note, op. cit.*, 1.

174 *Ibid.*, 2.

175 OECD, *Addressing the Tax Challenges of the Digitalization of the Economy – Public Consultation Document*, *op. cit*. For an overview of the main characteristics of the proposals discussed therein, vide: "Vikram Chand, "Allocation of Taxing Rights in the Digitalized Economy: Assessment of Potential Policy Solutions and Recommendation for a Simplified Residual Profit Split Method", *Intertax* 47, no. 12 (2019), 1023-1041.

176 OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy*, *op. cit.*

Participation (**"UP"**), and the Marketing Intangibles (**"MI"**)[177]. While doing so, we will demonstrate how these proposals reflected a shift in focus, showcasing how the international community increasingly saw in the ALS (or in an eventual *replacement*) the role of a *taxing rights redistribution mechanism*. We will also focus on demonstrating how these proposals brought a broader interpretation of value creation drivers and carried a message of an even *looser* ALS comparability notion. Please note that we will not discuss the nexus rules proposed changes, *per se* (i.e., the changes to the notion of *source* and the discussed introduction of a *market* nexus) as this falls outside of our delineated scope.

#### *2.1.8.1. The Significant Economic Presence*

Following the footsteps of the 2015 Final Report on BEPS Action 1[178], according to the 2019 Public Consultation, a SEP would be deemed to create a taxable presence in/nexus with a jurisdiction where digital businesses would, e.g., generate revenues, have user engagement or significant data collection, *regardless* of having, therein, a physical or taxable presence. In our view, this could have possibly been operated through the enlargement of the permanent establishment concept (e.g., trough changes in Article 5 of the current OECD Model Tax Convention), thus not necessarily creating an additional nexus, but rather reshaping the existing source nexus, observing current international tax framework. This idea was, at some point, defended by us elsewhere[179], as well as by authors such as Pistone[180] and Petruzzi[181], although with different particularities.

For our analysis, it is important to highlight that the profit allocation exercise to be conducted in the determination of the profits attributable to this 'digital' source nexus and the subsequent verification of this exercise's compliance with the ALS would most likely differ from current *praxis*. The necessary weighing of the new value drivers (e.g., user engagement and significant data collection) would pose challenges to the current transfer pricing methods' application. The much less benchmarkable/comparable features of user engagement or significant data collection (which would not necessarily

177 OECD, *Addressing the Tax Challenges of the Digitalization of the Economy – Public Consultation Document*, *op. cit*.

178 Organisation for Economic Co-operation and Development (OECD). *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, 2015.

179 *Vide*: Ricardo Sergio Schmitz Filho, *Towards a Broader Concept of Permanent Establishment: A Study in Light of the Digitalization of the Economy and the BEPS Era* (LL.M thesis, University of Lisbon School of Law, 2019).

180 Pasquale Pistone, João Félix Pinto Nogueira and Betty Andrade. "Comments submitted by The International Bureau of Fiscal Documentation (IBFD) Task Force on the Digital Economy" (OECD, Paris, 2019).

181 Raffaele Petruzzi, "Transfer Pricing, Users' Participation and Profit Attribution to Digital Permanent Establishments: A Case Study", *International Transfer Pricing Journal* 26, no. 2 (2019).

be directly linked to revenue generation) would lead either to *loosened comparability* standards - thus following our already discussed *trend* of stretching the notion of comparability - or to the use of *formulas*[182].

Some jurisdictions have, nevertheless, translated the idea behind the SEP in the introduction of unilateral digital services taxes (**"DST"**)[183]. Although these also target the role of redistribution of taxing rights, they are out of the scope of our analysis in this study.

### *2.1.8.2. The User Participation*

The 2019 Public Consultation's view on the UP approach argues that users significantly contribute to value creation in certain digital business models, such as social networks and search engines[184]. It emphasizes reallocating profits to jurisdictions where users are located, given their role in generating content, data, and network effects critical to the business's success[185]. The proposal shifts focus from capital and labour inputs to user interaction and engagement as key drivers of value[186].

The translation of these new value drivers into a transfer pricing and consequent arm's length assessment was left unclarified by the 2019 Public Consultation and significantly criticized by several stakeholders, within the responses submitted to the said consultation document. Raffaele Petruzzi wrote, back in February 2019, a very interesting and short case-based article illustrating what we consider to be a significant added-subjectivity to this assessment[187], in practice, able to further expand the taxpayer v. tax authority *gap*. As the mentioned author discussed, this *gap* can be as broad as leading to a zero-profit attribution (on a no significant people's function framework for a permanent establishment) to a large residual profit allocation based on a high-value/unique contribution measured through the application of a PSM[188].

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182 This conundrum was also presented in the IBFD Task Force on the Digital Economy's comments submitted to the OECD 2019 Public Consultation: Pistone, Pinto Nogueira and Andrade, *op. cit.*, 38.

183 Countries such as India, Israel and Italy have adopted taxes that can be considered as DST, as discussed, e.g., in Petruzzi, "Transfer Pricing, Users' Participation and Profit Attribution to Digital Permanent Establishments: A Case Study", *op. cit.*, 1.

184 Although, in reality, in a much broader *spectrum* of business models, as highlighted in, e.g.: Petruzzi, "Transfer Pricing, Users' Participation and Profit Attribution to Digital Permanent Establishments: A Case Study", *op. cit.*, 1 and Chand, "Allocation of Taxing Rights in the Digitalized Economy: Assessment of Potential Policy Solutions and Recommendation for a Simplified Residual Profit Split Method", *op. cit.*, 1029.

185 OECD, *Addressing the Tax Challenges of the Digitalization of the Economy – Public Consultation Document*, *op. cit*.

186 *Ibid*.

187 Petruzzi, "Transfer Pricing, Users' Participation and Profit Attribution to Digital Permanent Establishments: A Case Study", *op. cit.*, 4.

188 *Ibid.*, 3-4.

We believe, nevertheless, that user participation, although in many cases arguably capable of significantly adding value to MNE's businesses, cannot (and *should not*) be attributable to the MNE in itself (and its constituent units) and should not influence the ALS assessment as it - at least directly - does not influence unrelated parties pricing. This is not to say that this 'participation' (of such 'users') cannot (and should not) be *indirectly* captured within a transfer pricing assessment as in, e.g., functions related to market penetration, risks assumed in customers/users' relations and assets used to manage and enhance customers/users lists.

### *2.1.8.3. The Marketing Intangibles*

The MI is somewhat similar to the UP approach, as described above, but recognizably broader in scope[189].

The MI focuses on the intrinsic connection between marketing intangibles (e.g., trademarks, customer relationships, and proprietary market data) and the *market* jurisdiction. This connection arises because these intangibles derive value through customer engagement and activities within said market jurisdiction. The proposal justifies reallocating non-routine or residual profits to the market jurisdiction based on the role of these intangibles, even in cases of a lack of physical presence therein. According to the 2019 Public Consultation, the marketing intangibles are linked to the market jurisdiction in two primary ways: through the creation of customer goodwill and brand recognition rooted in the market and through activities like the acquisition of customer data or relationships[190]. These elements form the basis for changes in profit allocation rules, allegedly able to better reflect the value contribution of marketing intangibles[191].

As with the UP approach, the MI would face similar challenges when allocating profits based on consumer-facing intangibles like brand value and customer relationships.

Although the three analysed proposals could potentially misalign with the international tax framework, with the establishment of new nexus, likely not *prima facie* compatible with the bilateral treaties network (i.e., the OECD Model Convention), they would not *necessarily* cause similar disruptions in the sphere of the ALS and the

189 OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy: Policy Note*, *op. cit*. From that perspective, leading to a *less* ring-fencing solution than that proposed under the UP, as highlighted by: Chand, ""Allocation of Taxing Rights in the Digitalized Economy: Assessment of Potential Policy Solutions and Recommendation for a Simplified Residual Profit Split Method", *op. cit*., 1033.

190 OECD, *Addressing the Tax Challenges of the Digitalization of the Economy – Public Consultation Document*, *op. cit*.

191 *Ibid*.

authoritative statement of current Art. 9 of the OECD Model Convention[192]. Because of the mentioned wording of the 2019 Policy Note, nevertheless, at that point in time, a potential ALS disruption was still *possible*, following an eventual adoption of the proposed approaches.

The proposals encapsulated within the 2019 Public Consultation were, nevertheless, rapidly *forgotten* by the OECD, still in 2019 and, as already mentioned above, replaced with a very different 'Pillar I' approach (and a supplemented 'Pillar II').

### *2.1.8.4. The 2019 Programme of Work*

Following the several inputs received from the 2019 Public Consultation, already in May 2019, the OECD released the Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy [193] (**"2019 Programme of Work"**).

The SEP, UP and MI approaches, previously discussed, were supplemented by a revised profit allocation rule outline (together with revised nexus rules, which are out of our analysis' scope), including what the 2019 Programme of Work framed as the previously approaches *commonalities* – a *unified* approach[194]. Within the 2019 Programme of Work's initial analysis of these commonalities, important developments on the Organization's view on the ALS can be verified, significantly different from what we have seen in the 2018 Interim Report and going way further than the 2019 Policy Note's possible ALS flexibilization. *In verbis*:

> "[T]hey [the SEP, UP and MI approaches] have important common policy features, as they all contemplate the existence of a nexus in the absence of physical presence, contemplate **using the total profit of a business**, contemplate the **use of simplifying conventions (including those that diverge from the arm's length principle)** to reduce compliance costs and disputes – a feature supported by many commentators at the public consultation, who expressed concerns about approaches that would add complexity to existing tax rules –, and **would operate alongside the current profit allocation rules**."[195] (*Our highlights*).

It is important to note that this statement *expressly* brought back to the OECD's table discussions on possible adoption of an *enterprise approach* in transfer pricing (first highlight), as well as the use of some sort of *formulas* (second highlight). Although we have not stated ourselves whether these two elements would *necessarily* render the

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192 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, *op. cit.* Art.9. These proposals, if adopted, would, on the other hand, necessarily cause a significant increase in the subjectivity and, consequently, in transfer pricing related disputes, at least if without the resort to formula-based solutions/mechanisms.

193 OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy*, *op. cit.*

194 *Ibid.*, 11.

195 *Ibid.*, 11.

transfer pricing exercise at non-arm's length, the OECD went as further as it never did prior to the 2019 Programme of Work (and contrarywise to its own updated Transfer Pricing Guidelines wording[196]) and suggested that those features of the revised profit allocation rules, once developed, *could diverge* from the arm's length standard.

We will delve into the discussions around the eventual compatibility of *enterprise approaches* and *formulas* with the to be established *core* of the ALS and their possible iterations (third highlight above) below in the study.

As part of the then new unified revised profit allocation rules, the 2019 Programme of Work aimed at initiating discussions of different features/mechanisms to it, the first being a Modified Residual Profit Split (**"MRPS"**) method[197]. This new method would be designed to quantify the amount of profits to be (re)allocated to market jurisdictions – meaning a part of the MNE's deemed non-routine profit which would allegedly capture the value created in the market State that, according to the 2019 Programme of Work, would not be recognized under the existing profit allocation rules[198], as well as to establish how that allocation would work in practice. The application of a MRPS method would involve, still according to the 2019 Programme of Work, four steps. The analysis of these steps is crucial for our ALS time evolution study and will be conducted below.

The first step is the determination of the *total* profits to be split[199]. This is not a novel but reinstates a similar *partial* adoption of an enterprise approach in transfer pricing rules, as done with the introduction, at an OECD/international level, of the PSM, with the 1995 OECD Transfer Pricing Guidelines. The second step is to remove the routine profit, using either current transfer pricing rules or *simplified conventions*[200], which could represent a disruption in the OECD's long-lasting open rejection of the adoption of formulas in transfer pricing. The third step would involve the determination of the portion of that non-routine profit that would be in the scope of the new taxing right (to the market State). Here, the 2019 Programme of Work also added that such determination, as per the previous step, could be done either through current transfer pricing rules of via the use of simplified conventions/formulas. Lastly, the new MRPS method

196 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2022, *op. cit*.

197 OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy*, *op. cit*., § 28 ff.

198 Although, at that point in time, it is not clear to us whether by the use of the expression "existing profit allocation rules" the OECD was referring to the then current ALS variant or, broadly, to the ALS in itself. *Vide*: OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy*, *op. cit*., § 28.

199 OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy*, *op. cit*., § 28.

200 It is interesting why the OECD used the expression "simplified conventions" rather than a more straightforward term, such as "formulas". Perhaps the Organization's concern with not contradicting its own words, as craved in the Transfer Pricing Guidelines played a pivotal political role in this choice. For further analysis, the "simplified conventions" term should be understood as within the limits/frames of our Formula-Based Alternatives terminology, as discussed in Section 3.2. below.

would allocate such in-scope non-routine profit to the relevant market jurisdiction, using *allocation keys* (again, *formulas*).

Interestingly, as well, is the recurrent usage of a terminology that, up until this point in the *time* evolution of the ALS, was stigmatized by the OECD, such as the above highlighted 'allocation keys', but also 'formulas', and '*proxy*'. The later, for example, was used by the 2019 Programme of Work in advocating for the use, within a possible MRPS method application of "proxy based on projection of future income"[201], which would represent yet another stretch in the comparability notion within the ALS, following the adoption of the OECD's TNMM and the introduction of the specific PSM rules for the above discussed HTVI.

Although the 2019 Programme of Work points out, initially, that proposed changes would include, as we have highlighted, those that *diverge* from the arm's length standard, it goes to say that the MRPS method would have to integrate with existing transfer pricing rules *without* giving rise to double taxation or double non-taxation. In our view, this is hardly possible under *current* OECD Model Convention's Art. 9 authoritative statement, *unless* measures/changes would somehow be framed as *at* arm's length (within an arm's length *contour*). The OECD, at the time of the publishing of the discussed 2019 Programme of Work put itself, in our view, in a very similar situation as the US with the publication, in 1985, of the US House Bill 3838, as we have discussed above.

Other elements to the 2019 Programme of Work, beyond the MRPS method, include the introduced possibility of adoption of a *fractional apportionment* method. This reallocation mechanism, as put forward by the 2019 Programme of Work would perform the (re)allocation of taxing rights setting aside the efforts in determining the routine and the non-routine profits, which are key elements to the MRPS method above discussed, and considering, instead, the overall profitability of the MNE or of one of its specific business lines[202].

This approach is an even clearer expression of the enterprise approach in transfer pricing, as we will discuss under Section 3.1. below, when compared to the approaches above as, here, the method does not even seem to partially seek to replicate an ALS-like outcome (or *result*). Naturally, at that point, the 2019 Programme of Work did not contain enough information as to ascertain our latter consideration, but that was the initial impression from the document's wording.

Additionally, depending on how the elements chosen to compose the necessary operative allocation keys for the theorized fractional apportionment method relate to the overall results/profitability of the *other* units of the MNE, comparability standards in transfer pricing might be even further stretched. This is because it might be that a MNE unit 'A' would end up attracting more profits simply due to low performance of

201 OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy*, *op. cit.*, § 29 (Table.1.2).

202 *Ibid.*, § 29 (Table.1.2). Also, regional segregation is foreseen in the 2019 Programme of work, *vide* its same § 29 (Table.1.2).

its associated parties, and not necessarily because of its (*comparable*) functional profile analysis – as with the (already stretched) TNMM comparability.

Finally, the 2019 Programme of Work, also proposed work to be carried out under simplified approaches for *routine* profits determination, which is an important step towards the systematic introduction of (somehow pre-determined) formulas in transfer pricing[203]. This aspect of the 2019 Programme of Work is the precursor of Pillar I, Amount B, which will be discussed in detail below. Interestingly, for now, is to highlight that determination of routine profits based on formulas is precisely what many defenders of a "traditional" ALS assessment would call *arbitrariness*. We are not among those, but such a discussion will be retaken under the different parts of Section 3.2 below.

The important 2019 Program of Work set the grounds for what came to be famously known as the OECD Two Pillars Proposal. Due to the closer relation to our research endeavours, we will focus our comments, in the Sections below, on its first Pillar. Pillar II will be briefly discussed when bringing up the potential anti-competition role of the ALS.

### *2.1.9. The OECD Pillar I Proposal*

Following the publication of the 2019 Programme of Work, in the end of 2019, the OECD released a Public Consultation Document on the Secretariat Proposal for a 'Unified Approach' under Pillar One[204] (**"2019 Pillar I Public Consultation"**), in October, and another one on Global Anti-Base Erosion (**"GloBE"**) Proposal[205] (**"2019 Pillar II Public Consultation"**), already in November.

We find the Pillar I proposal, at least from the standpoint of the2019 Pillar I Public Consultation, still seemly incoherent. At the same time as it states its own incompatibility with the profit allocation authoritative statements of both Articles 7 and 9 of the OECD Model Tax Convention it states that:

> "It is also important that the new rules are reconciled with existing rules. That is the new rules should not create distortions and should be effectively applicable to both profits and losses."[206]

The OECD's belief, in this case stamped in the above wording of the 2019 Pillar I Public Consultation, that the proposed new rules would be able to *not* create

203 OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy*, *op. cit.*, § 29.

204 Organisation for Economic Co-operation and Development (OECD). *Secretariat Proposal for a "Unified Approach" under Pillar One: Public Consultation Document*. Paris: OECD Publications, 2019.

205 Organisation for Economic Co-operation and Development (OECD). *Global Anti-Base Erosion Proposal ("GloBE") – Pillar Two: Public Consultation Document*. Paris: OECD Publications, 2019.

206 OECD, *Secretariat Proposal for a "Unified Approach" under Pillar One: Public Consultation Document, op. cit.*, 9.

distortions is, in our view, either too ambitious or too naive.

Anyhow, the Sections below will discuss the influences of Pillar I constituent Amount A and Amount B upon the ALS *time* variants' evolution, which will be supplemented by further OECD and other stakeholders' studies on the topic, spamming all the way to the date in which this research is being conducted.

### *2.1.9.1. Pillar I, Amount A*

In 2020, the OECD released a Statement on 'BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy'[207] (**"2020 Statement"**) under which further Pillar I details were revealed. Although restricting what we have perceived to be the *beyond* arm's length approach suggested by the 2019 Pillar I Public Consultation now to Amount A (*residual profits*), the 2020 Statement maintained, at least partially, a "no connection to the arm's length principle" approach. We will further ahead discuss if we indeed see Amount A *logic* to be outside of the *core* of an arm's length's approach and, if so, if this is, in our view, a positive idea.

In short, according to the 2020 Statement, Amount A is defined as:

> "A share of residual profit allocated to market jurisdictions using a formulaic approach applied at an MNE group (or business line) level. 10 This new taxing right can apply irrespective of the existence of physical presence, especially for automated digital services. It reflects profits associated with the active and sustained participation of a business in the economy of a market jurisdiction, through activities in, or remotely directed at that jurisdiction, and therefore constitutes the primary response of the unified approach to the tax challenges of the digitalisation of the economy." [208]

We do have a few *substantial* disagreement points with Amount A proposal, as per its 2020 Statement *version*, which are presented below.

Firstly, we understand it is still possible allocate profits under the auspices of the authoritative statements of Art. 9 and, especially, Art. 7 of the OECD Model Tax Convention if the new *market* nexus would rather be constructed/framed as an updated/modified existing nexus (i.e., *source*). Naturally, this would require adjustments, especially to the comments to the mentioned Articles, but this certainly put much less pressure in a feasibility framework.

Secondly, and especially if the above suggestion would be followed, we do not necessarily agree with *Pillar I* frame of the proposed changes to the profit allocation rules as at non-/beyond arm's length. The political implications of moving forward with that would be enormous, risking undermining the feasibility of implementation of the revised profit allocation rules. The US has timely perceived such a mistake (or, softly put,

207 Organisation for Economic Co-operation and Development (OECD). *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy*. Paris: OECD Publications, 2020.

208 *Ibid*., § 10.

*risk*) back in the 1980's (in the context following the discussed US House Bill 3838) and we hope the OECD will learn with the experience/history.

Thirdly, we are not sure, at this point in time, if we agree that profits could/should be allocated without functions performed, assets used, and risks assumed. It is very arguable that a jurisdiction can contribute to a MNE ability-to-pay without being *directly* linked to any of these three key elements. Resorting to the foundations set out in the Four Economists Report, with which we basically started this journey, said contribution to the ability-to-pay would be a necessary justification for the existence of a taxing right and a consequent potential tax liability. It is not clear, at least looking at the 2019 Secretariat Proposal, whether the new/revised profit allocation rules establish this link clearly enough.

The allocation of profits without an even indirect relations to the functions performed, assets used, and risks assumed might risk creating a procedure beyond the even further stretched comparability requirements discussed up until this point in the time evolution assessment of the ALS.

Please note, nevertheless, that neither the second nor the third points above should lead to the automatic conclusion that Pillar I mechanisms are not welcomed. As our reader will shortly find, we, ourselves, drink from the fountain of the outlines of Pillar I propagated ideas, but we believe they should be *reframed* (as per our second point above) and their scope of application not only looked from a broader (economic) perspective, as we have already mentioned, but also revisited as to comply with the ability-to-pay foundations, thus also potentially substantiating the existence of a new taxing right, as per our third point comments above.

#### *2.1.9.2. Pillar I, Amount B*

As with the above discussed Amount A, both the 2019 Pillar I Public Consultation document and the 2020 Statement were additionally responsible for putting forward the outlines of the proposed Amount B, which were also tailored under the mentioned Report on Pillar One Blueprint[209], culminating in publication of the OECD Report on Pillar One – Amount B, in 2024[210] (**"2024 Amount B Report"**).

In short, the main *goal* of Amount B is to simplify the application of the ALS for what the OECD calls baseline marketing and distribution activities – in other words, to some (but not all) *routine* activities[211]. Regardless of the limitation of Amount B's scope, though, the simplification *goal* of the Amount B proposal is very much welcomed and something with which we substantially agree within the context of our views of the reimagination of the ALS, as we will thoroughly discuss under Chapters 3 and 4 below.

209 OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*, *op. cit*.

210 Organisation for Economic Co-operation and Development (OECD). *Pillar One – Amount B*. Paris: OECD Publications, 2024.

211 *Ibid*.

According to the OECD, this Amount B *simplification* would be operated through the *streamlining* of the framework for determining the arm's length returns. Initially, the 2020 Statement underscored the alignment of Amount B with the ALS[212], without expressly diving into the use of formulas to the mentioned streamlining exercise, while the 2024 Amount B Report comprehensively presented formulaic mechanisms (e.g., pricing matrixes and return-on-sales frameworks) to support Amount B in its endeavours[213].

Another important distinction (or, rather, evolution), between the 2020 Statement and the 2024 Amount B Report lies in the fact that the first framed Amount B as a tool to be globally mandatory (i.e., neither characterized as optional nor akin to a safe harbour), reflecting a commitment to universal adherence[214] while the 2024 Amount B Report shifted this perspective, introducing optionality, allowing jurisdictions to adopt Amount B voluntarily or mandate its use domestically. We will turn to the importance of this movement in the tailoring of ALS mechanisms in Chapter 4, when presenting our reimagination proposal.

Some of the criticism to Amount B was made in relation to the possible ALS deviations due to the 2024 Amount B Report reinstated proposition of the use of formulas (and even safeguards)[215]. As we will discuss under Section 3.2. below, we understand that *not every* formula-based alternative or solution is *necessarily* contrary to the ALS and, hence, we do not fully stand with these potential criticisms. We will, additionally, come back to the discussion and conclude on the eventual compatibility of Amount B with our arm's length core.

Looking at the *entirety* of Pillar I (Amounts A and B[216]), in a nutshell, it is not that the mechanisms proposed within the scope of Pillar I are necessarily unwanted. On the contrary, they do have several merits that can (and *should*) be taken into consideration, but under different circumstances, as we will further propose.

Note, nevertheless, that Pillar I is, currently, *not* a final product. We expect that the considerations made along this research and, especially, under Chapter 4, will contribute to the improvement of the OECD, the international community and, also, the EU work to follow in relation to this initiative.

### *2.1.10. The European Union*

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212 OECD. *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy, op. cit.*, § 58 ff.

213 OECD. *Pillar One – Amount B*, *op. cit.*, § 43 ff.

214 OECD. *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy*, *op. cit.*, § 58 ff.

215 OECD. *Pillar One – Amount B*, *op. cit.*, 2024.

216 Please note that Pillar I might also include a so-called *Amount C*, but, for the sake our proposed scope of analysis, this item is not discussed. *Vide*: Organisation for Economic Co-operation and Development (OECD). *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy*, *op. cit.*, § 10.

In recent years, the European Union has intensified its attention towards transfer pricing, minding, naturally, the global hustle around the topic in the last couple of decades. As such, the EU has put forward interesting proposals, documents, mechanisms, which will be presented/discussed below.

#### *2.1.10.1. The CCTB and the CCCTB*

The first examples of these can be found within the once very discussed Common Corporate Tax Base[217] (**"CCTB"**) and the Common *Consolidated* Corporate Tax Base[218] (**"CCCTB"**) Directive Proposals, initially put forward in 2011 and, later on, relaunched in 2016.

The CCTB proposal aimed at creating a uniform corporate tax base across the EU [219]. According to the EC, this would be a first step towards the adoption of a more ambitious proposal, the CCCTB, given the perceived unfeasibility of the later at current stage of development of the *time* evolution assessment of the ALS[220]. Still in accordance with the mentioned CCTB proposal, this first step would encompass solely "the elements of the common base, i.e. the rules for calculating the corporate tax base, including certain provisions against tax avoidance and on the international dimension of the proposed tax system"[221].

Although important in the context of the ALS time evolution, the CCTB does not, *directly*, alter the essence of the arm's length standard.

The CCCTB, therefore, would be the second step of the EC's view on reforming the corporate income taxation in Europe, at least until 2016. In addition to setting the common rules as described above, the CCCTB would introduce a *consolidated* tax base for MNEs in Europe, which would lead to an intra-EU *unitary taxation* of the qualifying MNEs, followed by an allocation of taxable profits based on a formulaic approach[222]. Both proposals were never adopted.

As we will further turn to, we see the CCCTB as an expression of a *hard* formula-based alternative to the challenges of the ALS, which we will deem non-compatible with our drawn feasibility framework.

Additionally, the European Commission published its Notion of State Aid[223], from

217 European Commission (EC), *Proposal for a Council Directive on a Common Corporate Tax Base*, COM(2016) 685 final, 25 October 2016.

218 European Commission (EC), *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base*, COM(2016) 683 final, 25 October 2016.

219 EC, *Proposal for a Council Directive on a Common Corporate Tax Base*, *op. cit.*

220 *Ibid.*, 3.

221 *Ibid.*, 3.

222 *Ibid.*

223 EC, *Commission Notice on the Notion of State Aid as Referred to in Article 107(1) of the Treaty on the Functioning of the European Union, op. cit.*

2016, and the Directive Proposal on Transfer Pricing[224], from 2023. The Sections below will delve into the details/analysis of these instruments.

### *2.1.10.2. The European Commission Notice on the Notion of State Aid Assessment*

The view of the ALS as an *anti-competition* instrument can be seen, within an EU context, even earlier than in the broader/international Pillar II context above, in our *time* evolution assessment. On the tail of the BEPS developments and the need to prevent abuses not only from the taxpayers' side, but also from States (i.e., to harmful tax competition), the European Commission started to connect the ALS (especially in face of *targeted* rulings or advance pricing agreements, but not only[225]) to the notion of (fiscal) State aid.

State aid is defined under Art. 107(1), TFEU, which states, *in verbis*:

> "Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to **distort competition by favouring certain undertakings** or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."[226]. (*Our highlight*)

Already for a couple of decades, the EC has applied the prohibition of State aid, as a competition law, to matters of taxation[227] - especially to direct taxation, given the higher stage of harmonization of indirect taxes in the EU[228]. Until very recently, though, this was not the case for the targeted (and broader) measures relating specifically to the ALS.

In 2016, the EC published a Commission Notice on the Notion of State Aid as Referred to in Article 107(1) of the Treaty on the Functioning of the European Union[229] (**"EC Notice"**). Paragraph 172 of the EC Notice (collated below) thus demonstrates that the ALS not only could be central to a (fiscal) State aid assessment, but that it would be an integral part of Article 107(1) in itself:

> "This arm's length principle necessarily forms part of the Commission's assessment of tax measures granted to group companies under Article 107(1) of the Treaty, independently

224 EC, *Proposal for a Council Directive on Transfer Pricing*, *op. cit.*

225 EC, *Commission Notice on the Notion of State Aid as Referred to in Article 107(1) of the Treaty on the Functioning of the European Union. op. cit.*, § 169 ff.

226 EU, *Consolidated Version of the Treaty on the Functioning of the European Union*, *op. cit.*, Art. 107(1).

227 Alexandra Miladinovic, in *Introduction to European Tax Law on Direct Taxation*, 8th ed., ed. Michael Lang *et al.* (Vienna: Linde International, 2024), 103.

228 *Ibid.*, 106.

229 EC, *Commission Notice on the Notion of State Aid as Referred to in Article 107(1) of the Treaty on the Functioning of the European Union, op. cit.*

of whether a Member State has incorporated this principle into its national legal system and in what form."[230]

This marked a significant moment in the time evolution of the ALS, especially in the EU, and led to the concomitant investigations carried out by the EC on the granting of (fiscal) State aid trough the conferring of *selective advantages*, by different EU Member States (e.g., Ireland, Luxembourg, The Netherlands, etc.) to different MNEs, especially relying on tax rulings (*advance pricing agreements*), in face of the issues (as we will further delve under Section 3.2 below) faced in the application of the transfer pricing methods.

The EC Notice, therefore, reveals the prominence of the ALS in Europe and reinforces our underlying premise of this work on the unfeasibility of solutions (here, especially, to be proposed within the EU) *openly* at non-arm's length.

We will turn back to the EC Notice in more details below (especially under Section 3.2), but the unsuccess of the EC to win cases in both the EGC and the CJEU in face of its application of the EC Notice, together with discussions on the competencies of the EC to *de facto* harmonize the ALS (direct taxation) in the EU led to the publication of a Council Directive on Transfer Pricing (**"Transfer Pricing Directive Proposal"**)[231], in 2023.

### *2.1.10.3. The Transfer Pricing Directive Proposal*

Following the unsuccess of the EC in progressing with the CC(C)TB package and, especially, the above unsuccess of the EC actions towards a case law based harmonization of the ALS in the EU, following its EC Notice[232], the same EC put forward its proposal for a Council Directive on Transfer Pricing, with the aim to introduce *binding* uniform (or *harmonized*) transfer pricing rules in the EU[233], based on a EC ALS *variant*. The Transfer Pricing Directive Proposal is part of a broader EC initiative, the Business in Europe: Framework for Income Taxation ("BEFIT") which, as a rebranding from the CCCTB, aims at improving the corporate income tax scenario in the EU, focusing on a deemed simplification and reduce of both administrative burden and disputes[234].

Despite criticisms to some of the technical choices and omissions of the Transfer

230 EC, *Commission Notice on the Notion of State Aid as Referred to in Article 107(1) of the Treaty on the Functioning of the European Union, op. cit*., § 172.

231 EC, *Proposal for a Council Directive on Transfer Pricing Rules and on a Common Framework for Transfer Pricing in the European Union*, *op. cit*.

232 We will turn to the EC position on the ALS within the recent CJEU case law under our Chapter 3 below.

233 EC, *Proposal for a Council Directive on Transfer Pricing Rules and on a Common Framework for Transfer Pricing in the European Union, op. cit*.

234 EC, *Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT), op. cit*.

Pricing Directive Proposal[235], it is undeniable that it presents itself as an important and interesting forum of implementation of a reimagined arm's length standard in the EU *praxis*. In this sense, we agree with Petruzzi and Myzithra when stating that:

> "The Proposal reflects the ambitious endeavour to implement a common set of transfer pricing rules in EU law and to achieve the highly welcomed goals of increasing tax certainty, reducing the risk of litigation and double taxation within the European Union, as well as compliance costs, improving competitiveness and efficiency and simplifying current transfer pricing rules in the European Union." [236]

We will further turn to the Transfer Pricing Directive Proposal when discussing the coordination nature of the ALS (within the discussions on the arm's length *core*), as well as further below, within our Chapter 4, on the discussions on the implementation steps of our proposed solutions to the challenges affecting the ALS. We will also highlight, therein, the importance of the Transfer Pricing Directive Proposal to a potential protagonism/pioneering of the EU in kick-starting the reimagination of the ALS.

All the EU documents analysed in this Section reveal the protagonism of the European Commission in the discussions around transfer pricing and the ALS. The case law in the EU, which we will shortly scrutinized, will further corroborate with this statement.

## 2.2. The *Core* of the Arm's Length Standard

Following the *time* (and *space*) variants', carefully assessed throughout this Chapter 2, and especially the directions to which the elasticity of the arm's length has been tested, the research has set the necessary foundations for us to establish a common *core* of the arm's length standard. This common core (or, simply, *core*) will be the backbone for the considerations to be made further along the studies. It will be confronted with the current ALS challenges and, especially, to the potential solutions applicable to them. Our established *core* will work both as a *benchmark* and as a *negative limitation* to our reimagination proposed solutions.

The drawn arm's length *core* will focus on the elements of *rationale*, *result*, *roles*, *compliance requirements* and *coordination* nature, as illustrated in the Figure below.

235 As our reader can see/refer to *in*: Petruzzi and Myzithra, *op. cit.*

236 *Ibid.*, 31.

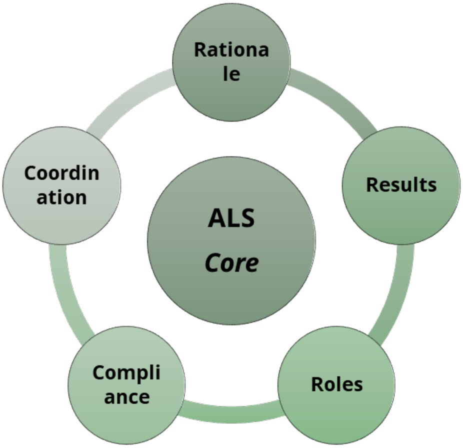

**Figure 1. The core of the Arm's Length Standard**

## *2.2.1. Rationale*

The *rationale* of the ALS lies in ensuring that financial or commercial conditions established between associated parties are those which would have been made between independent parties under similar circumstances. Although this terminology streams from the contemporary wording of Art. 9 of the OECD Model Tax Convention[237], our previously conducted arm's length *time* variants' analysis, under this Chapter, has shown the prevalence of this *logic* since the 1930's (and following the Carroll Report[238]).

As such, within a group/MNE set-up, the *consequences* of the *conditions* adopted in the controlled transactions must reflect, approximate, or rather, not distort the individual abilities-to-pay (principle) of each of the group/MNE's constituent units. In other words, the allocation must be carried out in respect of the *individual* ability-to-pay of each of the group/MNE constituent units, i.e., the ability-to-pay must not be accounted for on a *global*, *unitary*, group/MNE basis. The ALS *rationale* core, hence, is unable to accommodate profit allocation mechanisms which do not account for the impacts of intra-group relations within the group/MNE structure, although this is not to say that *certain* elements intrinsic to an MNE nature of doing business cannot/shall not be taken into consideration in an ALS assessment.

Consequently, the arm's length *rationale* shall ensure that profits are taxed in the jurisdictions where, generally, wealth is controlled or consumed or where income is generated or produced, as these tend to reflect that jurisdiction's role in contributing to the taxpayer's wealth and, by extension, to its *ability-to-pay*. We were keen in

237 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, *op. cit*.

238 Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, *op. cit*.

demonstrating that, although seeded on the Four Economists Report[239], this idea remained virtually untouched since then, despite the (re)growth of international and regional proposals akin to *unitary taxation*[240].

### 2.2.2. Results

The evolution of what shall be considered as an arm's length result and, perhaps more prominent, which ways/methods shall be able to lead to such results, was more turbulent than that related to the above ALS *rationale* core. It is worthy, therefore, to (re)structure our remarks within this Chapter 2, ultimately leading to our *result's* core definition below.

#### 2.2.2.1. The Fair and Reasonable Arm's Length Results

Until the publication of the US 1968 Regulations[241] and the introduction of the traditional transfer pricing methods, the ways to which groups/MNE demonstrated their results' compliance with the ALS were based, as we have had the chance to explore, on a subjective assessment of what would be *fair* and *reasonable*.

No objective, *strict*, comparability requirements existed for the first decades of the *time* evolution assessment of the arm's length standard.

#### 2.2.2.2. The Comparability Analysis and the Traditional Transfer Pricing Methods

Resort to a *strict* notion of comparability, as the *only* way towards the achievement of actual ALS compatible results can only be deemed to have existed from 1968 (in the US[242], but later on an international perspective[243]) to the late 1980's, early 1990's (thus lasting for less than a third of the chronological history of the ALS). In fact, and as we have demonstrated, the above-highlighted term 'only' is not precisely correct, even within this limited chronological *cut*, as most ALS *variants* included what could be called as the *fourth method*, in practice opening the doors for broader comparability approaches.

As such, *strict* resorting to comparable, as found within the *praxis* of the presented traditional transfer pricing methods shall *not* be the exclusive way towards an arm's length result and, as such, results achieved from broader comparability assessments are not, necessarily, at non-arm's length.

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239 League of Nations. *Report on Double Taxation Submitted to the Financial Committee*, *op. cit.*

240 As with the recent CCCTB in the EU. EC, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base*, *op. cit.*

241 United States Treasury Department, *Treasury Regulations on Income Tax: Section 1.482-1 (1968)*, *op. cit.*

242 *Ibid.*

243 Specially after the publication of the 1979 OECD Transfer Pricing Guidelines. OECD, *Transfer Pricing and Multinational Enterprises*, *op. cit.*

### *2.2.2.3. The Broader Comparability Analysis and the Transactional Transfer Pricing Methods*

Despite the initial political struggle of the transactional transfer pricing methods, as discussed, their broader comparability standards (thoroughly analysed within this Chapter) are, at least for the last couple of decades, widely accepted and adopted in practice, by virtually every single ALS *space* variant. Although returning to a state of subjectivity, closer to those of the initial ages of the ALS (or, perhaps, *surpassing* it), these new comparability standards were claimed as necessary for the maintenance of the ALS as a key element within the international tax set of rules.

The *time* evolution assessment has shown that the exercise of the comparability analysis encapsulated in both the TNMM and the PSM is, at least *theoretically*, capable of leading to arm's length results.

### *2.2.2.4. The Approximated Arm's Length Results*

Finally, the evolution of the different views on the arm's length results, and on the ways/methods employed to achieve them, have led to the conclusion that, especially in an increasingly complex economy, behaviours of both MNEs and independent parties are diverse, even if placed under similar circumstances. As such, the existence of feasible estimations, approximations and use of ranges are needed in the transfer pricing/ALS *praxis* and, as very-well established, must be seen as not contrary to the arm's length results core.

With that being said, it is relevant to note that, having a *single* arm's length result (while rare) shall also not be deemed contrary to the ALS results core, although *focusing* on its achievement might significantly impair the ALS operationalization, without significantly contributing to its effectiveness (i.e., approximation of the arm's length results is normal and *not* undesirable, as long as up to a certain extent).

The arm's length results *core*, hence, is far more open than the standard's current application conveys, although methods employed must always follow the arm's length *rationale* and other of its core elements, shall aim at mimicking the results which would be expected had the parties be independent from each other.

Nothing within either the broad comparability requirements or the approximate nature of the results indicates *a priori* incompatibility of *formulas* with the arm's length results core.

It is important to note that, following our comments within this and the above Sections, we have identified that, for some reason, it is common in our field's literature (and the vast OECD's cited work above is, generally, no exception) to see both the *rationale and the results* core of the ALS as the same as/overlapping with its "traditional" *variant* or its commonly shown face from the late 1960's to the late 1980's/early 1990's. This confusion/overlapping, although recurrent, does not contribute to a consistent necessary arm's length reimagination and is, therefore, demystified within our established arm's length *core*.

### *2.2.3. Compliance Requirements*

Compliance requirements have always accompanied the ALS *praxis*, although significantly varying in scope along its *time* evolution, especially related to the three main periods of understanding of *comparability* (and the underlying *evidence* gathering/presentation of such comparability). Currently, most ALS variant's compliance requirements are based on the OECD's three-tiered documentation structure, i.e., Local File, Master File and Country-by-Country Report[244].

Although it is a rather difficult task to positively delineate a compliance core of the arm's length standard, from this perspective, formal compliance *must* be able to demonstrate the arm's length's nature of its operator's application of a specific ALS *variant's rule*. In this sense, the *compliance requirements* core elements are intrinsically related to the ALS *results* core as, the more adequately the latter is structured, the easier it shall be for the ALS operators to fulfil the positive delineation of the compliance requirements core.

Alternatively, on a negative perspective, the compliance requirements would not be in line with an ALS understanding if its underlying administrative/administration burden, or costs, overcomes (or *shadows*) the ALS' other core elements[245]. Finally, now from a *rationale* perspective, the applicable compliance requirements shall not put its operators (i.e., MNEs) in a *significant* (unproportionally) worst position than independent undertakings in similar circumstances, as this may lead to an undesired compromise in the verification of the *actual* individual ability-to-pay of the constituent units of an MNE.

### *2.2.4. Roles*

#### *2.2.4.1. Profit Allocation Mechanism*

Based on our time evolution assessment, it seems indisputable that the original *role* (or *objective*) of the arm's length standard was to serve as a profit allocation mechanism, as to enable international economic growth, limiting situations of international double-taxation. This is clear from the analysis, e.g., of the ALS seeds in the incipient

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244 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2010. *op. cit.*, § 5.16 ff.

245 The high transfer pricing compliance costs are often mentioned within simplification proposals, as done already in 2001, by the Commission of the European Communities, in its communication on an Internal Market without tax obstacles, and, recently, within the European Commission proposal for a Council Directive on transfer pricing, in 2023. European Commission, *Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: "Towards an Internal Market without Tax Obstacles – A Strategy for Providing Companies with a Consolidated Corporate Tax Base for their EU-wide Activities"*, COM(2001) 582 final, 23 October 2001, e.g., § 44; EC, *Proposal for a Council Directive on Transfer Pricing Rules and on a Common Framework for Transfer Pricing in the European Union*, *op. cit.*, Explanatory Memorandum.

pre-War double-tax treaties[246] and for the main concerns underlying the initial documents we have analysed[247]. The role of the arm's length as a profit allocation mechanism has always been there and, as such, is perceived as a *necessary role* of the ALS.

### *2.2.4.2. Anti-Tax Avoidance Mechanism*

The role of an anti-tax avoidance mechanism was *not* expressly mentioned in the incipient documents referencing to the ALS or to its seeds, having it only appeared in legislations/official documents from the US Internal Revenue Act of 1934, Section 45[248], although yet very timidly. This concern was more strongly present from the 1970's and 1980's, as well illustrated by the 1988 White Paper[249], continuously growing from that moment onwards.

Since the BEPS project[250], in a more systematic fashion, the ALS has been considered as an (*important*) tool in the global fight against tax avoidance, a role which is also recognized in the OECD Transfer Pricing Guidelines[251].

In some instances, nevertheless, the ALS has even been considered as an instrument with a *primary* anti-tax avoidance role, as in some important cases at the Italian Supreme Court[252]. Although we cannot really side with this thought, contemporarily (and foreseeably ahead) it is not possible to dissociate the arm's length standard from that role. The ALS must not only concern itself with double taxation, but also with double *non*-taxation.

### *2.2.4.3. Taxing Rights Redistribution Mechanism*

Even more recently, the *time* evolution of the ALS has shown its *potential* application as a taxing rights redistribution mechanism. This comes because of the increasing global concern around the redetermination of the sharing of the pieces of the global

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246 As with the Austro-Hungarian treaty celebrated in 1899.

247 E.g.: League of Nations. *Report on Double Taxation Submitted to the Financial Committee*, *op. cit*. Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, *op. cit*.

248 United States. Internal Revenue Act of 1934, Section 45, *op. cit*.

249 Treasury Department Office of International Tax Counsel, Office of Tax Analysis, Internal Revenue Service, Office of Assistant Commissioner (International), Office of Associate Chief Counsel (International), *A Study of Intercompany Pricing*, *op. cit*.

250 *Vide*, OECD, *Addressing Base Erosion and Profit Shifting*, *op. cit*.

251 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 2022. *op. cit*., e.g., § 1.2.

252 E.g., Corte di Cassazione. *Italy vs. Solvay S.A.*, No. Sez. 5 Num. 24005, 23 October 2013, § 2.2.2; Corte di Cassazione. *Italy vs. Take Two Interactive Italia s.r.l., No. Sez. 5 Num. 11949*, 13 July 2012, § 2.3.2. Also discussed, in Italy, by Alessandro Albano: Albano, Alessandro. *Unresolved Issues Surrounding Transfer Pricing Legislation: The Anti-Avoidance Purpose and Penalty Protection – Part 1.* International Transfer Pricing Journal, 22, no. 1 (2015).

tax pie to the different jurisdictions, under an evolving underlying economic reality. The arm's length standard is, nonetheless, not the only tool deemed capable of fulfilling this *new role*.

The taxing rights redistribution role emerges as part of the OECD Pillar I proposal context[253] (actually, already since the kick-start of the "BEPS 2.0[254]). Although we have not understood such initiative to be *necessarily* contrary to the ALS, some items therein remain debatable, as we have already discussed above[255]. The uncertainties around the *actual* implementation of Pillar I (Amounts A and B), especially when compared to the well-established allocation and anti-avoidance roles of the ALS (combined with Pillar I rather restricted scope of application[256]) make this taxing rights redistribution role as a rather *optional* role for a specific ALS *variant*. In other words, we do not see this role as either necessary to the arm's length core or as necessarily contrary to it.

#### *2.2.4.4. Anti-Competition Mechanism*

The role of the ALS as an anti-competition mechanism derives from the fact that this standard should be capable of reducing the effectiveness of preferential tax regimes, implemented by certain jurisdictions to attract *artificial* economic activities/profits, as it shall limit the profits attributable to the MNE in that given jurisdiction in face of the absence of (or *reduced*) real economic activity. Furthermore, the ALS should also prevent the unilateral application of alternative allocation mechanisms, eventually capable of intentionally leading to a (at least partial) double non-taxation and preferential tax treatment for non-genuine activities.

Although we have not focused on the ongoing OECD Pillar II proposal (and on its underlying EU Directive[257]) it is important to note that it can be deemed responsible for the introduction of a stronger (*unprecedented*) anti-tax (jurisdictional) competition role for the *praxis* of the taxation of MNEs. Although this document does not *directly* relate to the arm's length standard (or to eventual direct substitutes), its adequate application presupposes the adequate application of the ALS, and, thus, is intrinsically related to the later[258].

Therefore, the same logic/conclusion as with the above taxing rights redistribution mechanism applies to the relation between the arm's length core's *role* and the anti-competition *function*.

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253 OECD, *Secretariat Proposal for a "Unified Approach" under Pillar One: Public Consultation Document*, *op. cit*.

254 As in: OECD, Inclusive Framework on BEPS: Progress Report July 2016 – June 2017, *op. cit*.

255 *Vide* our Section 2.1.9.2. above.

256 *Vide* our Section 2.1.9.2. above. *See* also: OECD, *Pillar One – Amount B*, *op. cit*.

257 Council of the European Union, *Directive on Ensuring a Global Minimum Level of Taxation for Multinational Groups in the Union*, *op. cit*.

258 As clearly read from Art. 16(4) of the Council of the European Union, Directive on *Ensuring a Global Minimum Level of Taxation for Multinational Groups in the Union*, *op. cit*., Art. 16 (4).

### 2.2.5. Coordination

#### 2.2.5.1. Uncoordinated Standard

The arm's length standard emerged as a *bilateral* solution to the arising double taxation issue[259], as we have thoroughly addressed within our time evolution assessment, in opposition to purely unilateral, domestic, measures with such an aim (role), as the US credit method, introduced in the early 20th Century[260].

In this context, the ALS was a fruit of a framework based on mutual concessions, upon certain agreed basis[261]. The original idea been, furthermore, the multilateral adoption of such mutual concessions. As such, and quite intuitively, the ALS requires *some* level of coordination in order to be even only potentially capable of fulfilling its original role. A *fully* uncoordinated standard cannot be deemed at arm's length.

#### 2.2.5.2. Semi-Coordinated Standard

The semi-coordination has, on the other hand, always permeated the ALS *praxis*. It started, as we have demonstrated, as a second-best solution (or a *temporary status*), towards the pictured multilateralism[262], but was rapidly seen as a feasible solution on which the international community decided to focus (*vide* the bilateral nature of not only the ALS, but the entirety of international taxation *praxis*). Currently, the application of both the OECD Transfer Pricing Guidelines by several domestic courts as a key interpretation guide to the ALS, and the widely adopted wording of Art. 9 of the OECD Model Tax Convention within the web of double-tax treaties indicate the prevalence, to a certain degree, of the semi-coordinated nature of the ALS[263].

Although multilateralism (or, at least, its idea) is indeed showing-off more prominently in the transfer pricing arena in the last few years, also from a regional (EU) perspective[264], a semi-coordinated nature is enough for the arm's length compliance, although the more towards *full* coordination of the elements to the ALS, the more effective it ought to be.

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259 As discussed in our *time* evolution assessment (Section 2.1.).

260 National Bank of Commerce in New York, *Federal Revenue Act of 1918: Complete Text with Reference Notes, Tables and Index op. cit*. *See* also: Avi-Yonah, "All of a Piece Throughout: The Four Ages of U.S. International Taxation," *op. cit*., 315.

261 *Vide* its integration in the early tax treaty *praxis*, as discussed in: Avi-Yonah and Lempert, "*op. cit*., 7 ff.

262 League of Nations. *Report on Double Taxation Submitted to the Financial Committee*, *op. cit*.

263 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit*.; OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*, *op. cit*., Art.9.

264 *Vide* our Section 2.1.10 above.

### *2.2.5.3. Coordinated Standard*

The existence of a *fully* coordinated ALS (i.e., unified) was, as mentioned, the initial idea of the very early ages of the arm's length development[265]. This has proven to be unfeasible and was, up until this moment, never achieved (nor shall be in the short to mid-term), being the Transfer Pricing Directive Proposal, although restricted to an EU scenario, the closer document (*yet in a proposal stage*) to arguably (and *partially*) fulfil this stronger coordination ideal[266].

In this regard, although desirable, the full coordination of the ALS (ultimately leading to the existence of a *single variant* in *space*) is not at all a necessity of the ALS core.

### *2.2.6. The Arm's Length Standard's Core Synthesized*

The arm's length standard is a *profit allocation* mechanism, applied to ensure that conditions made or imposed between the different constituent units of an MNE reflect or, rather, do not distort, their *individual ability-to-pay*, without, nevertheless, undermining the inherently characteristics justifying the carrying of business activities in the form of a group. The results reflecting these arm's length conditions must necessarily be based on a form of *comparability analysis*, considering the results which would have been expected had independent parties be under similar circumstances. Due to the economic reality behind any arm's length application, the arm's length can neither rely purely on *strict* comparability, nor on single results, thus the *approximate nature* of the arm's length results. Its compliance requirements are necessary to ensure the reliability of the arm's length results but cannot lead MNEs to significantly additional compliance burdens when compared to standalone undertakings.

To achieve consistent approximate arm's length results, ensuring the observance of the principle of single-taxation (neither double-taxation, nor double non-taxation), the arm's length standard needs to be adopted in, at least, a *semi-coordinated* manner globally, with an aim for a (closer to) full coordination in the future. A proper operation of the arm's length, following compliance with its core elements, shall ensure a proper functioning of the standard as an anti-tax avoidance mechanism, been its application also possibly related to efforts around (jurisdictional) taxing rights redistribution and anti-competition measures, as increasingly seen in the last few years in the international discussions.

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265 Already within the Four Economists Report: League of Nations. *Report on Double Taxation Submitted to the Financial Committee. op. cit.*

266 *Vide* our Section 2.1.10.3 above.

# CHAPTER 3: THE CHALLENGES TO THE ARM'S LENGTH STANDARD

As Chapter 2 has thoroughly demonstrated, the *time* evolution of the ALS has always been propelled by its underlying *challenges* (to its effective application). This evolution, therefore, has led us to what now, under our Chapter 3, we consider to be the most relevant *contemporary* challenges to an effective application of the arm's length standard and how, roughly over a hundred years after our starting point, an anachronic application of the arm's length standard might still lead to the original problem of double taxation, but, increasingly, as also stated before, to double non-taxation. In this sense, Chapter 3 rather represents a natural *continuation* from our Chapter 2. Chapter 4 will, while not *predict*, *propose* what are the next changes, twists to the arm's length contours and reimaginations to its operation, that might be able to cope up with our discussed *challenges*.

The sections below will, henceforth, address these main challenges to an effective application of the ALS/transfer pricing rules. As we have structured already in the introduction to this study, the challenges we are about to discuss are intrinsically related to the five identified elements to the arm's length *core*, emerging from our *time* evolution assessment. Right below, Section 3.1. will analyse the insufficiency of the entity approach, related to the *rationale* of the ALS. Section 3.2. will delve into the insufficiency of the transfer pricing methods and its consequences in terms of the arm's length *results*. Section 3.3. will discuss the arm's length increasing compliance complexity, in relation to the standard's *compliance requirements*. Section 3.4., in its turn, will present on the inefficiency of the arm's length *roles*, while Section 3.5. will touch on the conflicts of the different arm's length standards in relation to the *coordination* nature of the ALS.

All mentioned Sections will be accompanied by the introduction of discussions around the main already proposed alternatives to the identified challenges and their main shortcomings. Chapter 3 should, then, lay the necessary foundations for our *reimagination* outlines, to be discussed under the upcoming Chapter 4.

## 3.1. The Insufficiency of the Entity Approach

### *3.1.1. The Changes in Business Rationale*

Our *time* evolution assessment already demonstrated that the economy became more globally integrated. MNEs now account for a significant share of the global GDP[267], with associated-party trade comprising an increasing portion of overall

267 Already in 2001, Hubert Hamaekers, who chaired OECD's Working Party on Transfer Pricing and Multinational Enterprises and the Ad Hoc Group on Unitary Taxation in the 1980's, highlighted that "almost 70% of cross-border trade in the world takes place between related enterprises" in his: Hamaekers, *op. cit.*, 30.

trade[268]. Businesses have transitioned from one-entity, country-specific, models to global structures with highly integrated supply chains and functions. This shift has been amplified by sophisticated tax planning, raising challenges for international tax systems to keep pace with globalization's complexities, as we have already discussed under the arm's length *time* variants evolution analysis within Section 2.

Focus on these concerns reached its (already a decade-long standing) peak with the previously presented OECD 2013 Action Plan on Base Erosion and Profit Shifting[269], which systematically identified the need to address the tax challenges arising from such practices in a highly *interconnected* economy[270]. Although Final Reports were issued in 2015, no comprehensive solution to the identified misalignment *taxation x* (*MNE*) *economic reality* was presented.

As we have demonstrated, several fronts were opened by the OECD since then, starting from a more 'digital economy' segmented solution, within its 2018 Interim Report on Tax Challenges Arising from Digitalisation[271], somehow set aside, to its broader 2019 Public Consultation Document on Addressing the Tax Challenges of the Digitalisation of the Economy[272], opening the door to the Two Pillars *hot topic*, as we have mentioned under Chapter 2. Unilaterally, as demonstrated within our arm's length *space* variants analysis, several proposed measures (not necessarily within the realm of a traditional ALS or even corporate income tax) proliferated. While the still developing OECD so-called Two Pillars proposal excites some more than others, one thing is certain - the views on the ways forward with a *strict* entity-based ALS, within the context of rapid economic and regulatory changes, are certainly not clear.

While the current OECD Transfer Pricing Guidelines maintains an expressly *strict* adoption of the entity approach[273], the same OECD Guidelines seems to already attenuate this approach, by mentioning, e.g., that *incidental* benefits attributable solely to being a part of a MNE should *not* give rise to the existence of a transaction and, consequently, of a remuneration between the parties (i.e., payments would be deemed unnecessary)[274].

Important exceptions to a *strict* entity-based approach are also found within the

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268 OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, op. cit*.

269 OECD, *Action Plan on Base Erosion and Profit Shifting, op. cit*.

270 *Ibid*.

271 OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS. op. cit*.

272 Organisation for Economic Co-operation and Development (OECD). *Addressing the Tax Challenges of the Digitalisation of the Economy – Public Consultation Document*. Paris: OECD Publications, 2019.

273 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit*., Preface, § 6 ff.

274 *Ibid*., §7.9 – 7.10.

discussed Pillar I Amount B[275], although the actual implementation of these, at some point, is still questionable.

These examples can, hence, be understood as the already existing foreseen of different facets of an *enterprise* view (or points towards that end within an entity *vs.* enterprise approach *continuum*) in the arm's length *praxis* and a partial recognition of the *strict* entity approach *failure*. After discussing the different angles (and reflexes) of the fundamental issues with the entity approach, we will delve into the details of our mentioned *continuum*.

### *3.1.2. The Fundamental Issues with the Entity Approach*

What is certain is that these transformations in the global business *rationale* highlight how MNEs have become the *rule*, while fully independent companies, operating solely in the market, have become the *exception*. In this context, the traditional (*strict*) entity approach in transfer pricing, while treating each group company (or unit) as a fully independent actor, increasingly misaligns with the economic reality. The arm's length assessment, originally designed to compare associated-party transactions with those between fully independent entities, now faces the challenge of comparing the rule (MNEs) to the exception (independent companies), inverting the assessment's order from the time the ALS was conceptualized, where independent entities were the norm, and associated-party synergies were far less prevalent.

The primordial question that arises is, therefore, whether, in a contemporary *business* context, associated parties are still in a comparable *organization* and *market* position to independent parties. Authors such as Aitor Navarro defend that "MNEs' and independent parties' *rationales* do not coincide in organization or market terms, and, thus, cannot be regarded as comparable"[276]. We would not go that far, rather advocating for a not *full* comparability.

Although departing from a slightly different premise than Aitor Navarro, we reach a similar conclusion. The consequence of the lack of (*full*) comparability in terms of organization and market position (and that context is important to bear in mind) between MNE and independent parties is that, although the ALS should *approximate* the profit allocation exercise within the MNE structures to that between independent parties under similar contexts, the ALS should not, in Aitor Navarro's words, "result in an unabridged levelling"[277]. That author continues to say, and we agree, that "[i]n other words, if one pushes the [*strict* entity-based] arm's length fiction to its furthest point [in our *continuum*], i.e., to match the outcome of controlled and uncontrolled transactions, the outcome would be against the principle of equality, as equalization of

275 As in: Organisation for Economic Co-operation and Development (OECD). *Pillar One: Blueprint for Addressing the Tax Challenges of the Digitalisation of the Economy*. Paris: OECD Publications, 2020.

276 Aitor Navarro, "The Arm's Length Standard and Tax Justice: Reflections on the Present and the Future of Transfer Pricing," *World Tax Journal* 10, no. 3 (2018), 360.

277 *Ibid.*, 361.

incompatible scenarios is also against this principle"[278].

We have already used these arguments when presenting our ALS *rationale* core above and it seems clear, therefore, that maintaining a *strict* entity approach risks creating distortions by disregarding the business peculiarities (and the *interconnectedness*) inherent to MNEs.

These distortions are already discussed in the literature.

Initially, it might be argued that a *strict* entity approach can undermine the economic efficiencies and synergies that ultimately justify operating as a group. According to Aitor Navarro, these are reflected in e.g., the removal of transaction costs[279], the possibility of removal of competitors from the market[280], and the possibility of more efficient coordination of different stages of production/business[281]. Such issues are also debated by Avi-Yonah and Benshalom[282], as well as by Fleming Jr., Peroni and Shay[283].

The OECD argues, nevertheless, that the *strict* entity approach-based ALS *can* accommodate these MNEs inherent synergies, still allowing for their recognition using mechanisms such as the cost-plus method, profit split, or other approaches that reflect the benefits derived from the group's integrated structure. These methods would potentially be able to allocate profits based on the economic value generated from the synergies, ensuring that relations/transactions between group members reflect their contributions. According to the OECD, therefore, this approach maintains consistency with the ALS while recognizing that group-wide cooperation can lead to greater overall profitability that should be shared among the entities involved[284]. This message was also put forward by the 2015 Final Reports on BEPS Actions 8-10[285].

We cannot *fully* agree with that and will come back to these discussions below.

The main unresolved problem, in our view is, nevertheless, the inability of this *strict* entity approach-based ALS to accommodate logical (or *rational*) business decisions that might make sense in a group/MNE set-up, but that would not be observed within independent party behaviours. These threats were subject to the scrutiny of different courts, within the realm of different arm's length *space variants*.

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278 Navarro, "The Arm's Length Standard and Tax Justice: Reflections on the Present and the Future of Transfer Pricing", *op. cit.*, 361.

279 *Ibid.*, 358.

280 *Ibid.*, 358.

281 *Ibid.*, 358.

282 Avi-Yonah and Benshalom, *op. cit.*

283 J. Clifton Fleming Jr., Robert J. Peroni and Stephen E. Shay. "Is Unilateral Formulary Apportionment Better than the Status Quo?" *in The Allocation of Multinational Business Income: Reassessing the Formulary Apportionment Option*. Ed. Richard Krever and François Vaillancourt. Series on International Taxation, v.76. Wolters Kluwer. 2020: 172.

284 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*. *op. cit.*, especially in §§ 1.177-1.193.

285 OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports*. *op. cit.*, 9-12.

Consequently, by not properly *limiting* the entity approach, the ALS risks misaligning or even disregarding the economic realities within which it is applied and penalizing MNEs, potentially undermining the business *rationale* for MNE structures by an *unabridged levelling* with independent parties expected behaviours. This issue is also valid in permanent establishment situations, especially when the attribution of profits thereto is based on an arm's length logic, and follows the so-called Authorized OECD Approach (**"AOA"**) (as in many jurisdictions) in which the profit allocation exercise to the permanent establishment is similar to that with another MNE *entity*, based, therefore, in a separate entity approach logic[286].

As we will discuss below, the misalignment issue and the potential undermining of MNEs businesses have also significant implications/reflexes when examined under the lens of EU Law and the fundamental freedoms enshrined in TFEU[287], which might also render the current *strict* entity-based ALS non-compatible with EU Law.

### *3.1.3. The Barriers to the EU Fundamental Freedoms*

The reflexes of the adoption of our criticized *strict* entity approach-based ALS in the EU are also significant, contributing, as we will demonstrate, to its unsustainability in a global, but especially in a European context.

A step-back is, nevertheless, necessary for this assessment. As such, it is worth mentioning that, although *direct* taxation is not *explicitly* regulated by the TFEU, the latter aims at ensuring that matters related to the internal market are of shared competence of both the Union and the Member States[288]. Hence, direct taxation norms found within domestic tax systems of the different Member States, capable of impacting on the integration of the internal market, must be compatible with EU Law and its objectives and, consequently, might be scrutinized by the CJEU[289].

The understanding evolved into a long-lasting position of the ECJ (*now* CJEU) that tax norms specifically targeting cross-border transactions and arrangements, otherwise *comparable* to purely domestic arrangements, have discriminatory/restrictive effects upon the TFEU fundamental freedoms and, consequently, would require a

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286 As sistematized from the: Organisation for Economic Co-operation and Development (OECD). *Report on the Attribution of Profits to Permanent Establishments.* Paris: OECD Publications, 2018. The topic is also extensively discussed by Raphael Holzinger *in*: Holzinger, Raphael. *Die Ergebnisabgrenzung bei verbundenen Unternehmen und Betriebsstätten post BEPS*. Series on International Tax Law, Volume 120. Austria: Linde Verlag, 2020.

287 EU, *Consolidated Version of the Treaty on the Functioning of the European Union*. Examples include Articles 18 (prohibition of discrimination), 21 (freedom of movement and residence), 45 (free movement of workers), 49 (freedom of establishment), 56 (freedom to provide services), 63 (free movement of capital and payments), and 110 (prohibition of discriminatory taxation). *op. cit.*

288 *Ibid.*

289 For the introductory notions/aspects of the EU tax law *see*, e.g.: Michael Lang et al., eds., *Introduction to European Tax Law on Direct Taxation*, 8th ed. (Vienna: Linde International, 2024) and Juliane Kokott, *EU Tax Law*, 1st ed. (Oxford: Beck/Hart, Bloomsbury Publishing, 2022).

*justification*. This understanding can be traced all the way back to *Avoir Fiscal*[290], in the 1980's, and was sustained in a long series of cases such as in *Daily Mail*[291], *ICI*[292], *X and Y*[293], *Lankhorst-Hohorst*[294], *Marks & Spencer*[295] and *Cadbury Schweppes*[296].

From the *SGI* case[297], this understanding was specifically confronted to arm's length/transfer pricing norms. In short, the case related to SGI, a company established in Belgium, which granted an interest-free loan to a related company, Recydem, a tax resident of Luxemburg. The Belgian tax authorities issued a revised tax assessment, increasing SGI's taxable base by adding a notional interest of 5% on the loan. This adjustment was based on Art. 26 of the Belgian Code des Impôts sur le Revenue, which allowed the value of unusual or gratuitous advantages to be added back into the profits of the donor for tax purposes, unless these advantages were included in the recipient's taxable income. The provision specifically required such an adjustment in cases where the recipient was a related foreign company.

A question raised by both the Belgian and the German governments then was around an alleged lack of *comparability* between a pure domestic situation, *not* subject to the described Art. 26 of the Belgian *Code des Impôts sur le Revenue*, and the case of MNEs (such as SGI and Recydem)[298].

Here, one must be careful (and *precise*) with the understanding of the underlying notion of *comparability*, as used in different parts of this Chapter 3. One assessment, as discussed above, is about the comparability within a *market/operational* logic. A second one relates to the comparability of situations in an EU Law context. The analysis regarding the *first* comparability assessment is already made above, while the second, as raised by the mentioned Belgian and German governments in *SGI*, is our current object of analysis, specifically regarding the EU background.

At the *SGI* time, within her opinion to the case, Advocate General Kokott had not gone into the details on those governments' arguments, but rather impliedly took

290 European Court of Justice (ECJ). *Commission of the European Communities v. French Republic*, Case 270/83, ECLI:EU:C:1986:37, §§ 25–27.

291 European Court of Justice (ECJ). *The Queen v. H.M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc*, Case 81/87, ECLI:EU:C:1988:456, § 16.

292 European Court of Justice (ECJ). *Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)*, Case C-264/96, ECLI:EU:C:1998:370, §§ 21–23.

293 European Court of Justice (ECJ). *X and Y*, Case C-200/98, ECLI:EU:C:2000:617, §§ 26–28.

294 European Court of Justice (ECJ). *Lankhorst-Hohorst v. Finanzamt Steinfurt*, Case C-324/00, ECLI:EU:C:2002:749, § 32.

295 European Court of Justice (ECJ). *Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes)*, Case C-446/03, ECLI:EU:C:2005:763, §§ 31-34.

296 European Court of Justice (ECJ). *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, Case C-196/04, ECLI:EU:C:2006:544, §§ 41-46.

297 CJEU, *Société de Gestion Industrielle (SGI) v. État belge*, *op. cit.*, §§ 39-55.

298 *Ibid.*, § 41.

by grant the comparability of the situations[299]. The CJEU did not dedicate significant scrutiny to the *comparability* aspect either and understood the situation to be comparable[300].

Although the CJEU later replicated this comparability understanding in other specific arm's length/transfer pricing norms cases, such as *Itelcar*[301], *Hornbach-Baumarkt*[302] and *Lexel*[303], the discussion got additional components from the publication of the opinion of the Advocate General Bobek in the mentioned *Hornbach-Baumarkt* case[304].

Hornbach-Baumarkt AG was a company established in Germany that provided comfort letters to banks in support of loans granted to its subsidiaries in the Netherlands, Hornbach Real Estate Groningen BV and Hornbach Real Estate Wateringen BV, *without* receiving a remuneration. These subsidiaries had negative equity capital and required bank loans to ensure the continuity of their business operations and to finance the planned construction of stores. Due to this fragile financial position, the bank ensuring the financing of those companies had made the granting of the loans' contingent on the provision of the mentioned comfort letters containing guarantee statements from Hornbach-Baumarkt AG[305].

As the German tax authorities understood that unrelated third parties, in similar circumstances, would have agreed on a remuneration for the provision of said comfort letters/guarantees, it adjusted Hornbach-Baumarkt AG's taxable income by adding the presumed remuneration for the guarantees granted to its Dutch subsidiaries, based on the Paragraph 1 of the German *Außensteuergesetz*, which allowed income adjustments when transactions between a German and a foreign related party, deviated from arm's length terms[306].

In his opinion to the *Hornbach-Baumarkt* case, Advocate General Bobek, reinforcing that the issue of comparability that we have been analysing was "apparently not discussed"[307] in *SGI*, argued, contrarywise to both Advocate General Kokott and the CJEU in the latter case, that associated party transactions and independent party transactions were *not* to be considered as comparable, from an EU ALS/transfer

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299 Juliane Kokott, Opinion in *Société de Gestion Industrielle (SGI) v. État belge*, Case C-311/08, ECLI:EU:C:2009:545, § 50, delivered on 10 September 2009.

300 CJEU, *Société de Gestion Industrielle (SGI) v. État belge*, *op. cit.*, §§ 41-46.

301 Court of Justice of the European Union (CJEU). *Itelcar – Automóveis de Aluguer Lda v. Fazenda Pública*, Case C-282/12, ECLI:EU:C:2013:629, § 19.

302 CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit.*, § 35.

303 Court of Justice of the European Union (CJEU). *Lexel AB v. Skatteverket*, Case C-484/19, ECLI:EU:C:2021:34, §§ 35-41.

304 Michal Bobek, Opinion in *Hornbach-Baumarkt AG v. Finanzamt Landau*, Case C-382/16, ECLI:EU:C:2017:974, delivered on 14 December 2017.

305 CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit.*, §§ 4-8.

306 *Ibid.*, § 11.

307 Bobek, Opinion in *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit.*, § 56.

pricing perspective[308].

Advocate General Bobek argued, following the position of the German government, that cross-border transactions, where profits could be shifted out of that tax jurisdiction, were fundamentally different from domestic transactions, under which profits remained within the country's right to tax (under the principle of territoriality). Having the first the aim at preventing profit shifting by adjusting taxable income to reflect arm's length conditions would, therefore, inherently make domestic and cross-border transactions incomparable from a tax law perspective, indicating that for national rules specifically designed to prevent tax base erosion applying different treatment to foreign subsidiaries would not constitute discrimination under the freedom of establishment[309].

Sustaining this understanding would, inevitably, lead to a conclusion that no restrictions' assessment would even exist, and that the ALS could, pragmatically, *escape* from the CJEU scrutiny.

The CJEU in *Hornbach-Baumarkt*, nevertheless, sustained that the German government arguments (followed by Advocate General Bobek) do not relate to *comparability* (under our second understanding of the term), "but rather to the justification derived from the principle of territoriality, whereby Member States are entitled to tax income generated on their territory, or connected with the need to preserve the allocation of powers of taxation between Member States, which is a legitimate objective recognised by the Court[310]". With that statement, the CJEU thus maintained its *SGI* position on the comparability of the situations.

We believe, as does Rafaelle Petruzzi and Svitlana Buriak[311], that siding with both the German government and Advocate General Bobek's opinion and, thus, *merging* the justification assessment within the *ante* comparability analysis would render the proportionality test void (or, rather, inexistent). Well, following such a *merger*, if a domestic legislation is justified (on acceptable grounds), this would lead to the conclusion of the existence of a non-discriminatory measure, thus leaving the potentially (un)proportionality assessment out of the scrutiny of the CJEU which could lead to barriers to the development of the internal market which would outweigh the benefits of its justifications.

This understanding was also followed by Advocate General Kokott in the *Nordea* case, although not specially related to the ALS[312]. There, Advocate General Kokott stated, *in verbis*:

> "If it is ultimately concluded that the situations are not objectively comparable, then, unlike in the context of considering a ground of justification, there is no examination of the

308 Bobek, Opinion in *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit.*, §§ 56-69.

309 *Ibid.*, § 56-69.

310 CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit.*, § 40.

311 Raffaele Petruzzi and Svitlana Buriak, "Freedom of Establishment and Transfer Pricing Threats for the EU Single Market," *International Transfer Pricing Journal* 25, no. 4: 308-309.

312 Court of Justice of the European Union (CJEU), *Nordea Bank Danmark A/S v. Skatteministeriet*, Case C-48/13, ECLI:EU:C:2014:2087.

proportionality of the difference in treatment of domestic and cross-border situations. It is thus no longer possible to strike an appropriate balance between the objectives associated with the fundamental freedom and those underlying the ground for differentiation between domestic and cross-border situations. A balanced solution is therefore guaranteed only where the ground for a difference in treatment is considered in the context of the examination of a ground of justification[313]."

Rafaelle Petruzzi and Svitlana Buriak also put forward an interesting argument according to which, even if the objectives/justifications of the ALS/transfer pricing rules were to be analysed within the comparability assessment, cross-border and domestic situations *could* be viewed as comparable (i.e., targeted towards the same objective) as, although less prevalent, domestic transactions between related-parties might also give raise to profit shifting and artificial tax planning through transfer (mis)pricing[314]. This is especially true (or more visible) where free/special economic zones exist (e.g., Madeira, in Portugal, Klaipeda, in Lithuania, but many others in the EU and elsewhere), but also trough more sophisticated exploring of loopholes in the domestic legislation.

Although we have not seen this specific argument raised in the CJEU case law, we agree with that and will come back to it further ahead in this study.

Consequently, in an EU context, this understanding *could* lead to the conclusion that, for cases under which the ALS/transfer pricing rules would *not* apply to domestic situations, as for the German legislation in *Hornbach-Baumarkt*, comparable situations would be treated differently, hence giving raise to the discrimination/restriction. The conclusion could, potentially, differ for the cases in which ALS/transfer pricing rules applies to domestic situations, as cross-border and domestic situations, being comparable, would *theoretically* be subject to similar treatments, thus being able to set aside the discrimination element. Of course, for the latter understanding/conclusion to apply, an *in-casu* analysis of the legislation implementing the ALS/transfer pricing rules would have to be conducted to verify the *actual* equal treatment of the cross-border and domestic situations[315].

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313 Opinion of Advocate General Kokott, *Nordea Bank Danmark A/S v. Skatteministeriet*, Case C-48/13, ECLI:EU:C:2014:153, § 27, delivered on 13 March 2014.

314 Petruzzi and Svitlana Buriak, "Freedom of Establishment and Transfer Pricing Threats for the EU Single Market," *op. cit.*, 309-310.

315 For example (and referring to the above cited summary presented by Svitlana Buriak and Raffaele Petruzzi), many countries have the requirement of arm's length observance also applicable to domestic transactions, but the formal requirements (i.e., documentation, economic analysis performance and update, etc.) are only (or mostly) applicable to cross-border situations, thus, in the end, also creating a difference in treatment between domestic and cross-border situations. An example of that is Lithuania, see: Minister of Finance of the Republic of Lithuania, *Order No. 1K-123 of 9 April 2004 on the Approval of the Implementation Rules of Article 40(2) of the Law on Corporate Tax and Article 15(2) of the Law on Personal Income Tax*, Official Gazette 2004, No. 58-2074; as last amended by Order No. 1K-470 of 31 December 2018, published in TAR 2018-12-31, i.k. 2018-22117 (consolidated version from 1 January 2021), Art. 2 and Art. 87.

All in all, although not without disputes, the comparability of domestic and cross-border situations, within an ALS/transfer pricing assessment, has shown to take prevalence in the ALS/ fundamental freedoms related cases in the ECJ/CJEU, and is also agreed upon by us. Hence, we can conclude that the application of ALS/transfer pricing norms, potentially leading to pricing adjustments, increased taxation, double-taxation, or higher compliance costs, for example, can make it *less attractive* for companies which are resident in one Member State to establish subsidiaries in another Member State rather than domestically. Current ALS should, therefore, is to be considered as discriminatory/restrictive by the CJEU and, *prima facie*, incompatible with EU Law, at least from the prism of the fundamental freedoms.

### *3.1.3.1. The Restrictive Strict Entity-Based Arm's Length Standard*

At this point, our reader might have notice that, within the discrimination/restriction assessment, the *rationale* of the arm's length standard (as per our determined *core* elements) is *not yet* a decisive factor – we will get to it.

For now, it is important to perceive that a restrictive domestic legislation (i.e., those containing the ALS/transfer pricing rules) might relate to one of the four fundamental freedoms foreseen in the TFEU, namely the free movements of goods, persons (under which we have the expression of the freedom of *establishment*), services and capital, all *more* or *less* liable to be affected by direct taxation (and ALS) provisions[316]. Understanding the fundamental freedom to which the specific domestic measure under the lens of the CJEU primarily relates is something the Court always does in its assessment – one might argue that it serves as a guidance on the election of case-law jurisprudence, on the analysis of the consequences of the measure and its potential argued *justifications*.

When analysing the material scope, and, consequently, the applicable (*restricted*) freedom from the EU Law perspective[317], the Court, as in *Thin Capitalization Group Litigation*[318] and *Cadbury Schweppes*[319], have asserted that, where *definite influence* powers exist, such as in associated party or group transactions, the freedom of *establishment* should take prevalence. Any resulting effects on the free movement of capital or services have rather being considered as *unavoidable* consequences[320]. Therefore, within the realm of the ALS, the *restriction* has repeatedly been framed by the Court

316 Lang *et al.*, eds., *op. cit.*, 61-62. As mentioned by the authors, the free movement of *goods* is rarely affected by direct taxation measures though.

317 For an overview of the Court's approach, in a broader tax context, *see*: Lang *et al.*, eds., *op. cit.*

318 European Court of Justice (ECJ). *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, Case C-524/04, ECLI:EU:C:2007:161, §§ 26–35.

319 ECJ, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, *op. cit.*, §§ 29–33.

320 *See*, e.g., the mentioned case law: ECJ, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, *op. cit.*, §34; ECJ, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, *op. cit.*, §33.

within the scope of Art. 49, TFUE[321], the freedom of establishment, as in the discussed *SGI*[322] and *Hornbach-Baumarkt*[323].

This is *not* to say that broader tax issues cannot be (and are not) framed within the material scope of different fundamental freedoms, whenever their restrictive potential is verified. It is the case, for example, with issues related to personal income taxes, as in the landmark *Schumacher*[324] case, analysed within the realm of the free movement of workers. It is also *not* to say that current freedom of establishment prevalence would always/necessarily apply to ALS related cases. Although the *definite influence* element would always be there[325], other freedoms, such as the free movement of capital (Art. 63, TFEU[326]), currently treated by the Court as unavoidably affected, might take protagonism in case of an EU-wide adopted ALS variant, as the free movement of capital would be the only potentially applicable towards the restriction regarding third States. This possibility was very interestingly raised by Stefan Mayer[327], but also discussed in the context of the Court's decisions[328].

For now, it remains imperative to *firstly* address the current (OECD) ALS potential incompatibilities with EU Law through the prism of the freedom of establishment, which, as discussed, has emerged as the predominant framework in the CJEU's jurisprudence. To do so, we will begin by critically examining the un-updated *strict* entity approach embedded in the OECD's ALS, as a relevant element whose limitations risk exacerbating the ALS's restrictive effects - or unproportional justifications for those effects - within the EU's integrated market.

#### *3.1.3.2. The Commercial Justifications within a Strict Entity-Based Arm's Length Standard*

As the restrictive character of the ALS is *inherent* to its entire being and, hence, to its own nature, its analysis *did not* require a separate assessment of the different

321 EU, *Consolidated Version of the Treaty on the Functioning of the European Union*, *op. cit.*, Art.49.

322 CJEU, *Société de Gestion Industrielle (SGI) v. État belge*, *op. cit.*, § 36. This is also mentioned as 'relationship of interdependence', as stated in: European Court of Justice (ECJ). *Baars v. Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem*, Case C-251/98, ECLI:EU:C:2000:205 and also mentioned in: Petruzzi and Buriak, "Freedom of Establishment and Transfer Pricing Threats for the EU Single Market," *op. cit.*, 2.

323 CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit.*, §28.

324 European Court of Justice (ECJ). *Finanzamt Köln-Altstadt v. Roland Schumacker*, Case C-279/93, ECLI:EU:C:1995:31, §§ 22-24.

325 CJEU, *Itelcar – Automóveis de Aluguer Lda v. Fazenda Pública*, *op. cit.*, § 18.

326 EU, *Consolidated Version of the Treaty on the Functioning of the European Union*, *op. cit.*, Art.63.

327 Stefan Mayer, *Formulary Apportionment for the Internal Market* (Amsterdam: IBFD, 2009).

328 As highlighted in: Confédération Fiscale Européenne (CFE) ECJ Task Force. "Opinion Statement ECJ-TF 1/2019 on the CJEU Decision of 31 May 2018, in Case C-382/16, *Hornbach-Baumarkt*, Concerning the Application of Transfer Pricing Rules to Transactions Between Resident and Non-Resident Associated Enterprises." Submitted to the EU Institutions, April 2019, §16.

ALS *rationale* elements, as we have alerted our reader. On the other hand, *now*, the analysis upon the necessary grounds, steps, or requirements for *justification* of the *restrictive* face of the ALS must be addressed from different, and significantly more specific, angles, essentially considering *rationale* (entity *vs*. enterprise approach) aspects/elements.

In *SGI*, the Court presents us with an excellent overview/summary of the different perceived necessary steps for *justifying* the application of a (restrictive) arm's length standard, which would also be mirrored in the following ALS-related CJEU cases. Its paragraph 71 states, *in verbis*:

> "National legislation which provides for a consideration of objective and verifiable elements in order to determine whether a transaction represents an artificial arrangement, entered into for tax reasons, is to be regarded as not going beyond what is necessary to attain the objectives relating to the need to maintain the balanced allocation of the power to tax between the Member States and to prevent tax avoidance where, first, on each occasion on which there is a suspicion that a transaction goes beyond what the companies concerned would have agreed under fully competitive conditions, the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide **evidence of any commercial justification** that there may have been for that transaction."[329] (*Our highlight*)

Further sections of this study will comprehensively address the hassles of identifying the existence of actual 'objective and verifiable criteria' within the ALS application - as *SGI*'s first sort of validation criteria (intrinsically related to the insufficiency of the transfer pricing methods - our Section 3.2). It will also turn to the ALS capabilities of fulfilling its roles as to 'maintain the balanced allocation of the power to tax between the Member States and to prevent tax avoidance' (related to the inefficiencies of the ALS roles, Section 3.3). Finally, this study will also delve into the question of current ALS 'undue administrative constraints' (within the increasing compliance complexity, Section 3.4).

We will first, nevertheless, focus on the highlighted 'evidence of any commercial justification that there might have been for that transaction', as the adoption of our above discussed *strict* entity approach-based ALS might (and, in fact, does) pose problems which are specifically related to this *SGI* set requirement.

In fact, what we have just called *SGI set requirement* was already rooted in the Court's decision in *Thin Capitalization Group Litigation*[330] and later replicated in *Test Claimants in the CFC and Dividend Group Litigation* [331], but was actually first constructed by Advocate General Geelhoed in his opinion to the first mentioned case which, in its paragraph 67, states:

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329 CJEU, *Société de Gestion Industrielle v. Etat belge*, *op. cit*., §71.

330 ECJ, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, *op. cit*., § 82.

331 Court of Justice of the European Union (CJEU), *The Test Claimants in the CFC and Dividend Group Litigation v. Commissioners of Inland Revenue*, Case C-201/05, ECLI:EU:C:2008:239, § 84.

> "(…) It must be possible for a taxpayer to show that, although the terms of its transaction were **not arm's length**, there were nonetheless genuine commercial reasons for the transaction other than obtaining a tax advantage. (…)"[332] (*Our highlight*)

Well, although in *Thin Capitalization Group Litigation* the Court has explicitly referred to Advocate General Geelhoed's paragraph 67, the wording used by the first did not indicate that the commercial reasons which would have to be allowed to taxpayers could potentially be at *not* arm's length. The Court in *SGI*, referring to *Thin Capitalization Group Litigation*, also did not use such terms as in Advocate General Geelhoed's opinion, paragraph 67.

Advocate General Kokott's opinion to the *SGI* case is also relevant to this discussion. Within her opinion and referring specifically to the two other cases we have being debating, Advocate General Kokott also indicates that "legislation intended to combat abuse must give the taxpayer, on each occasion on which an artificial arrangement is suspected, the opportunity to provide evidence of any commercial justification that there may have been for that arrangement.[333]" Although the departing point is fundamentally similar to that of Advocate General Geelhoed, her conclusions were substantially different, from our point of view, as expressed in her paragraph 78 to the *SGI's* opinion, in *verbis*:

> "(…). That provision does not exclude the possibility for the taxpayer to contest any such assessment made by the tax authorities. For those purposes, it must prove that the contested transaction is in fact economically justified, and that independent companies **acting at arm's length** would have concluded the transaction on the same terms."[334] (*Our highlight*)

Later, in *Hornbach-Baumarkt*, the CJEU added additional elements to the discussion, when, in paragraph 54 of its decision, stated that:

> "In a situation where the expansion of the business operations of a subsidiary requires additional capital due to the fact that it lacks sufficient equity capital, there may be commercial reasons for a parent company to agree to provide capital on **non-arm's-length terms**."[335] (*Our highlight*)

Similarly, the German Finanzgericht Rheinland-Pfalz, when referring the case, worded that:

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332 Opinion of Advocate General Geelhoed, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, Case C-524/04, ECLI:EU:C:2006:417, § 67. In his Opinion, Advocate General Geelhoed refers to the *Halifax* case, which, nevertheless, relates to indirect taxation, *see*: European Court of Justice (ECJ), *Halifax plc and Others v. Commissioners of Customs & Excise*, Case C-255/02, ECLI:EU:C:2006:121, §§ 74-75.

333 Juliane Kokott, Opinion in *Société de Gestion Industrielle (SGI) v. État belge*, *op. cit.*, § 77.

334 *Ibid.*, § 78.

335 CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit.*, § 54.

> "The referring Senate therefore considers it necessary to clarify whether a legal provision such as § 1 (1) in conjunction with § 1 (2) no. 1 3. para. 2 no. 1 3. alt. AStG 2003 fully satisfies the requirements of Community law regarding the possibility of providing evidence of economic reasons for the **deviation** of a business relationship established between persons associated under company law **from the arm's length principle**."[336] (*Our highlight*)

The main question lies, therefore, in precising the meaning of the expression *non-arm's-length terms* (or the *deviation from the arm's length principle*).

As Buriak and Petruzzi very well put, two interpretations could derive from the use by the Court, in *Hornbach-Baumarkt*, of the highlighted expression. In a first assessment, it would mean that *non*-arm's length reasons could be put forward by taxpayers while, alternatively, these reasons could only be contrary to *certain* arm's length *terms* (what, in our adopted terminology, would be the expressions of a particular arm's length *space variant*, reflected in, e.g., traditional comparability elements of current OECD arm's length *variant*)[337].

Advocate General Bobek, in his already mentioned opinion to *Hornbach-Baumarkt*, seemed to have sided with the first interpretation. According to him, the commercial reasons or justifications were to be viewed as a deviation from the ALS in itself, thus being reasons or justifications at *not* arm's length. In our understanding, this opinion comes as a natural corollary of Advocate General Bobek's already discussed *strict* entity-based view of the ALS's *rationale*. For him, any such view of group interests (even though as limited as it could be) would inevitably render the relationship at *not* arm's length. He, in his conclusions – although not followed by the Court – did not argue in favour of the openness of the commercial justification and, thus, from that angle, regarded an ALS legislation, not allowing the taxpayer to provide *commercial reasons* (such as in Germany) justified by its own means, or nature.

On the other hand, Buriak and Petruzzi, while siding with the second interpretation, put forward that there may be commercial reasons applied to a group setting which would deviate from independent parties' behaviours. Well, such explanation can only be sustained within an understanding of the ALS which would encompass at least *some* elements of an enterprise approach.

In *Hornbach-Baumarkt* circumstances, under which no third party would have agreed on providing a guarantee, and the parent company should not have charged any guarantee fee, the taxpayer should, therefore, be able to provide commercial reasons for this behaviour, in line with the correct application of the arm's length standard[338].

We side with this second interpretation – understanding that this was (or, at least, should have been) also the understanding of the CJEU in *Hornbach-Baumarkt*. In this

336 Finanzgericht Rheinland-Pfalz (1st Senate). *Germany vs Hornbach-Baumarkt AG*, Case 1 K 1472/13, § 37.

337 Svitlana Buriak and Raffaele Petruzzi, "Transfer Pricing Rules under the ECJ's Scrutiny: Green Light for Non-Arm's Length Transactions?" *International Transfer Pricing Journal* 25, no. 5 (2018).

338 *Ibid.,* 359.

case, the relevance of the ALS would be safeguarded, since the provision of commercial reasons should be granted only in cases of correct application of the standard, as stated by Buriak and Petruzzi[339].

The conclusion is, henceforth, that a *strict* entity approach-based ALS not only risks the undermining of global business rationale but also renders the standard non-compatible with EU Law. Commercial justifications *must* somehow be integrated in an ALS *praxis* assessment. This understanding is also substantiated by the German Finanzgericht Rheinland-Pfalz[340], following the CJEU decision in *Hornbach-Baumarkt*, and, e.g., by the Italian Corte di Cassazione[341].

It is imperative, though, to understand the limits of the deviations of *current strict* entity-based ALS, within the realm of these commercial justifications. In other words, the limits on how far towards the enterprise-end of our drawn *continuum* can an ALS understanding go. The CJEU has, up until this moment, not significantly contributed to the delineation of these limits, although paragraph 56 of the same *Hornbach-Baumarkt* sets some interesting elements for discussion:

> Accordingly, there may be a commercial justification by virtue of the fact that Hornbach-Baumarkt AG is a shareholder in the foreign group companies, which would justify the conclusion of the transaction at issue in the main proceedings under terms that deviated from arm's-length terms. Since the continuation and expansion of the business operations of those foreign companies was contingent, due to a lack of sufficient equity capital, upon a provision of capital, the gratuitous granting of comfort letters containing a guarantee statement, even though companies independent from one another would have agreed on remuneration for such guarantees, could be explained by the economic interest of Hornbach-Baumarkt AG itself in the financial success of the foreign group companies, in which it participates through the distribution of profits, as well as by a certain responsibility of the applicant in the main proceedings, as a shareholder, in the financing of those companies."[342]

The different limits on how these and further expressions of group interests in the ALS assessment can be assimilated will be discussed below, in connection with the different points of our entity vs. enterprise approach *continuum*.

339 Buriak and Petruzzi, "Transfer Pricing Rules under the ECJ's Scrutiny: Green Light for Non-Arm's Length Transactions?" *op. cit.*

340 Finanzgericht Rheinland-Pfalz (1st Senate). *Germany vs Hornbach-Baumarkt AG*, *op. cit.*, § 39. The Finanzgericht Rheinland-Pfalz has also put forward a compeling argument regarding the obstacles in simply recharacterizing a potential "remuneration free" loan (or guarantee fee) into a capital/equity contributation, given the broader than transfer pricing considerations which could arise from that, and the need to observe non-artificial business strategies, *see* Finanzgericht Rheinland-Pfalz (1st Senate). *Germany vs Hornbach-Baumarkt AG*, *op. cit.*, § 34-36.

341 Corte di Cassazione. *Italy vs GI Group S.p.A.*, Case 13850/2021, May 2021, § 1.5.

342 CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit.*, § 54.

### 3.1.4. The Enterprise Approaches Alternatives

As discussed, from a general/international perspective, but also from an EU standpoint, a *strict* entity-based approach ALS is *undesirable*. Having demonstrated the reasons for that, we have also somehow introduced different set of alternatives to such – traditional – ALS view. While doing so, we have presented/structured them in a *continuum*, which departs from stricter positions, moving towards stronger enterprise approaches. The present Section will, in a structured way, address these alternatives, with a more technical eye. Further sections will add closer lens to the specific points of our *continuum*.

Initially, we can trace a parallel between what we have previously described and called as a *strict* entity approach-based ALS to what Aitor Navarro presents as a *full arm's length fiction*[343]. The same author then makes an important distinction between his *full* arm's length fiction and an also his *limited* arm's length fiction. According to the first, mirroring our *strict* entity approach-based ALS, all relations between associated parties must be priced, which includes *conditions* originated by the will of the parties as well as incidental consequences (*circumstances*) of MNE membership. His *limited* arm's length fiction, on the other hand, is differentiated by the fact that those *circumstances* are not to be priced.[344]

In our entity *vs.* enterprise approach *continuum*, Aitor Navarro's *limited* arm's length fiction is already a step in the direction of the latter, with a clear, yet timid, demonstration of a consideration of group interests in the arm's length assessment and, henceforth, a movement towards the introduction of *elements* of an enterprise approach to the ALS. As the first, although misaligned with contemporary business *rationale*, is clearly compatible with our established arm's length *core*, the second also is, given the solidified usage of the OECD Guidelines examples in the transfer pricing *praxis*[345], as already mentioned above.

In a third point of our *continuum*, following the same 'towards enterprise approach' direction, already extrapolating from Aitor Navarro's proposed points, lies what we call the *light enterprise approaches*. In short, within this view, beyond the disregarded *circumstances*, as within the second point, some *conditions* might also be disregarded (i.e., not priced) in the arm's length assessment process. Because of the openness/subjectivity of which conditions are to be disregarded, actual different light enterprise approaches could be defined, making them not a *point*, as mentioned above, but, rather, a *range* in our *continuum*. These *conditions* would be what we have already briefly mentioned, but will later further discuss, as being *rational business conducts/conditions*.

343 Navarro, "The Arm's Length Standard and Tax Justice: Reflections on the Present and the Future of Transfer Pricing," *op. cit.*, 361.

344 *Ibid.*, 361 ff.

345 Although expressly still rejected by some, as, e.g., by Advocate General Bobek in his already discussed opinion to *Hornbach-Baumarkt*: Michal Bobek, Opinion in *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit.*, § 115.

The section below will delve into the details (and expressions) of these *light* enterprise approaches and conclude on their eventual compatibility with our established arm's length *rationale* core, as discussed above.

Following, we will do a similar exercise for the last point of our *continuum*, the *hard* enterprise approach. Based on the same elements we have above been using for the classification of points within this *continuum*, in a *hard* enterprise approach, both *conditions* and *circumstances* between associated parties are disregarded and not priced, as the different units of an MNE are seen as an inseparable organism.

The figure below illustrates our entity *vs.* enterprise approaches *continuum* in transfer pricing.

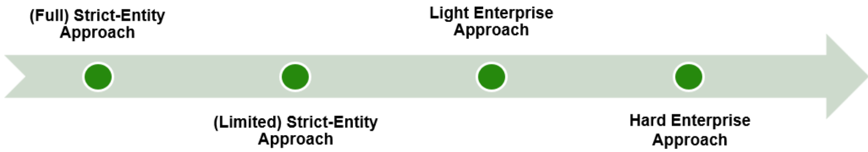


**Figure 2. The entity vs. enterprise approaches continuum**

### *3.1.4.1. The Light Enterprise Approaches*

Defining the limits to the light enterprise approaches' range is most certainly not an easy task. This effort is intrinsically related to our already introduced discussion spamming from *Hornbach-Baumarkt*[346] paragraph 56 and how the different group interests (reflected in their *conditions*) could/should be assimilated by the ALS.

These limits, in our view, must be drawn *not* based on the assessment of the technical difficulty degree, e.g., on *conditions* which *could/must* be priced, although arguably difficult to. Throughout the *time/space* variants' evolution of the ALS, relevant examples of these can be highlighted, e.g., related to the topic of *financial transactions* (and underlying interest rates applicable)[347], as showcased in the famous Australian *Chevron* case[348] and to the application of *economic valuation techniques*, also within a CUP

346 CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit.*, § 56.

347 We will turn ahead to the difficulty in testing the arm's length nature of financing transactions and the potential limitations of our proposed reimagination of the arm's length standard in face of such.

348 Federal Court of Australia*, Australia v. Chevron Australia Holdings Pty Ltd [2017] FCAFC 62, 21 April 2017.*

method issue, as in the recent *DCF AG* in Austria[349] and the French *SA SACLA*[350]. It is worth mentioning that, in many cases, the potential technical difficulties in pricing certain conditions have been used by taxpayers in attempts to *artificially* avoid taxes.

Alternatively, the boundaries to the light enterprise approaches and to the consequent disregard (non-pricing) of certain conditions shall be drawn based on the *economic rationale* of such (not on the technical issues above mentioned). These *conditions*, although more easily priceable (from a technical standpoint), *should* not be in a given specific case. As in *Hornbach-Baumarkt*[351], the not-to-be-priced *conditions* might not (in principle) pose significant technical hassles, as they do not (also in principle) contain the *artificiality* element. The substantiation for their non-pricing shall lie on the fact that, although not verified in independent parties' scenarios, such *condition* would be likely to represent a behaviour which would/could be perceived had this verification been possible in an independent parties' scenario. Such *conditions*, therefore, convey a strong economic reasoning, beyond the mere tax advantage consideration.

It is important to highlight, additionally, that the mere argument that the benefits obtained by the entity grating a gratuitous benefit is the expected receipt of *dividends* should not, in itself, make the *condition* to fit in our not-priced category. Otherwise, the ALS would be emptied of any meaning, as a parent is *always* expected to receive a dividend from the subsidiary, thus making any gratuitous *conditions* justified. This cannot be sustained.

We conclude, hence, that the limits to the light enterprise approaches ranges are characterized by the assimilation, within the ALS praxis, of the possibility of not pricing conditions falling under our above-described boundaries. We will, from this point onwards, and for the sake of our further considerations, call this characterization/definition the *rational business conducts*.

We can also conclude that this light enterprise approach *range*, within our entity vs. enterprise approach *continuum* should be regarded as compatible with the ALS *core's rationale*.

Well, the OECD Transfer Pricing Guidelines themselves acknowledge that associated parties *may* engage in transactions that would/could not be undertaken by independent parties and that these transactions "may not necessarily be motivated by tax avoidance but may occur because in transacting business with each other, members of an MNE group face different commercial circumstances than would independent

349 Bundesfinanzgericht (Federal Finance Court), *Austria v. "DCF AG"*, Case No. RV/7103521/2019, September 2024.

350 Cour Administrative d'Appel de Lyon, *SA SACLA v. French Tax Authorities*, Case No. 22LY03210, 6 July 2023. We will also turn to the topic of the difficulty in testing the arm's length nature of economic valuation techniques applied within a CUP model when discussing our proposed solution to the ALS challenges and its underlying limitations.

351 CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit*.

enterprises"[352]. Hence, the OECD recognizes, within the same paragraph 1.11, that "the mere fact that a transaction may not be found between independent parties does not of itself mean that it is not arm's length"[353].

This also corroborates with our subscribed interpretation of the necessary openness of the transfer pricing rules to commercial justifications, as we have presented above that, not been verified in independent party transactions and, hence, not necessarily comparable/benchmarkable under certain (traditional) arm's length terms, can still be at arm's length.

In a nutshell, again, our light enterprise approaches range should be seen as compatible with the ALS *rationale*, even if deviating from certain arm's length variants *terms*, as we have discussed above.

#### *3.1.4.2. The Hard Enterprise Approaches*

Finally, under the hard enterprise approaches, the constituent units of an MNE would be treated as a single inseparable unit, thus, neither the *circumstances* nor the *conditions* made or imposed between these different constituent units of the MNE, would be directly accounted for in the determination of the taxable profits of these constituent units in the different jurisdictions.

The discussed CCCTB proposal, in Europe, can be said to be an example of our categorized hard enterprise approach in transfer pricing[354].

As such, allocation mechanisms would be implemented solely for the purposes of distributing the rights to tax of portion of the MNE's profits to the different involved jurisdictions, but the individual ability-to-pay of the constituent units would not be accurately determined/taken into account. As such, we deem the hard enterprise approaches to be contrary to our established arm's length *rationale* core.

#### *3.1.4.3. Key Issues with the Enterprise Approaches and the Rational Business Conducts*

Being compatible with the ALS *rationale* is a prerequisite, within our *drawn feasibility framework*, for the proposal of introduction of any alternative to current OECD ALS's *variant* - but is not the only one. It is imperative that any proposed alternative should be potentially capable of mitigating the negative effects of the underlying analysed challenge to which it pertains.

In the case of the light enterprise approaches and the tolerance towards what we have framed as rational business conducts, their benefits, as discussed above, seem

352 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*, especially in § 1.11.

353 *Ibid.*, § 1.11.

354 EC, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base op. cit. Vide* our Section 2.1.10.1.

unquestionable, but they are not unaccompanied by potential *negative* spillovers in other challenges, which we will turn to in the upcoming sections.

Firstly, a structural introduction of light enterprise approaches/rational business conducts in the ALS *praxis* could increase subjectivity. This could be verified trough an increased role of judgment calls, from both taxpayers and tax administrations alike, which would lead to added uncertainty, lack of tax and legal certainty and increased disputes around transfer pricing. These consequences could, potentially, jeopardize the possible alternatives to the remaining challenges – as would be the case with those targeting the arm's length result's challenges and those deriving from the arm's length compliance requirements as well.

As we will discuss under our Chapter 4, therefore, an *isolated* structural introduction of light enterprise approaches/rational business conducts in the ALS *praxis* is not recommended.

### *3.1.5. Summary*

Both the *time* and *space* variants' evolution of the ALS indicate an insufficiency of a strict entity approach, in face of its misalignments with the changes in the global business *rationale*, intensified in the last decades. As demonstrated, the maintenance of a strict entity approach-based ALS risks creating an unabridged levelling between MNEs and independent undertakings. This leads to a potential undermining of the economic efficiencies and synergies that ultimately justify operating as a group. A strict entity approach-based ALS is deemed unbale to accommodate logical (or *rational*) business decisions that make sense in a group/MNE set-up, but that would be observed in independent party behaviours – what we have called the rational business conducts.

The challenges associated with the insufficiency of a strict entity approach-based ALS are also reflected in the EU, which tend to render said ALS non-compatible with EU Law. As we have demonstrated trough the analysis of CJEU case law, this non-compatibility would stream from a potential failure of a strict entity approach-based ALS to pass a justifications test within a CJEU fundamental freedoms' assessment – a challenge whose prelude can already be found under the discussed decisions and opinions, especially under *SGI* and *Hornbach-Baumarkt* cases.

The enterprise approaches alternatives to the identified *rationale* challenges, in the EU but broader, were presented as points (or *ranges*) within an entity vs. enterprise approach *continuum* – a full and a limited strict entity approach, followed by a light enterprise approach range, culminating in a hard enterprise approach. The distinguishing element been how the different *conditions* (and *circumstances*) between the different units within an MNE are assimilated by a certain ALS *variant*.

We have concluded, within this Section, that a *light* enterprise approach should be capable of introducing, to the ALS *praxis*, a required observance to what we have called the rational business conducts, thus potentially tackling the challenges related to the insufficiency of the strict entity approach-based ALS – an issue of *rationale*.

We have added, nevertheless, that a structural implementation of a light enterprise approach-based ALS might lead to negative spillovers on increased subjectivity to the arm's length assessment, increased tax and legal uncertainty and transfer pricing disputes. Consequently, any attempt to implement a light enterprise approach solution must be done in coordination with additional measures/instruments.

## 3.2. The Insufficiency of the Transfer Pricing Methods

Beyond issues related to the misalignment with contemporary business *rationale*, current OECD ALS *variant*, whose pragmatical expressions lie in the application of transfer pricing methods and the underlying (different) notions of *comparability*, is confronted with the challenge of lack of (adequate) *comparable*.

This challenge is not disconnected from the misalignment of the ALS *rationale* with the contemporary economic reality. Rather, the issue of lack of comparable, which leads to the insufficiency of the transfer pricing methods, has its roots also on the fact that the ALS is now comparing the *rule* with an (in many cases *theoretical*) *exception*. This Section 3.2., also referring to our ALS *time variants* evolution assessment, will delve into how the different pragmatical expressions of the ALS (transfer pricing methods) were gradually contaminated by this issue and how it has increasingly led to what we call the *randomization* of the arm's length *results*, thus rendering the methods inefficient, or *insufficient*. As previously done within Section 3.1. above, we will also turn to the reflexes of these challenges in an EU context, which will help to further strengthen our arguments. Finally, this Section will present what could be the alternatives to the insufficiency of the transfer pricing methods and what potential shortcomings would have to be addressed for their successful implementation.

### *3.2.1. The Lack of Comparable*

#### *3.2.1.1. The Traditional Transfer Pricing Methods*

As we have discussed under Section 2.1.5. above, the 1968 Regulations in the United States kick-started the institutionalization of the resorting to *comparable* as the predominant arm's length *verifier*, within the now called *traditional* transfer pricing methods (i.e., *CUP*, *RP*, *CP*)[355].

Although we have recognized, along with Avi-Yonah[356], that the institutionalization of the *traditional* comparability requirements (i.e., relying on *comparable* transactions) ought to reduce the instability of the ALS from the late 1960's, such requirement quickly proved to be problematic for a *panacea* of real-life cases, thus putting in check the *stricto sensu* comparability assessment in the transfer pricing *praxis*. Comparable

355 Avi-Yonah. *The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation. op. cit.*, 9-10.

356 *Ibid.*

are simply not available.

This was not only recognized in case law, as we have already had the chance to demonstrate within our ALS time *variants* evolution assessment, but already the 1979 OECD Transfer Pricing Guidelines, when referring to the CUP, stated that:

> "(…) in principle the [comparable uncontrolled price method] is the most appropriate [method] to use and in theory the easiest. In practice, however, it often happens that such evidence is not available or it is impracticable to collect it together or there is argument about whether the prices quoted are comparable or not. Other methods may therefore need to be used to obtain an arm's length price."[357]

Such recognition of the lack (or *unavailability*) of comparable in the application of the CUP method was reinstated in every subsequent version of the OECD Transfer Pricing Guidelines[358]. Several commentators have, therefore, used these shortcomings as reasons substantiating the introduction of the *transactional* methods (i.e., the TNMM and the PSM) by several jurisdictions following the publication of the 1995 OECD Transfer Pricing Guidelines and the practical use of such by taxpayers' already years before.

Contemporarily, the *limited* application of the CUP method is a reflex of this issue. Based on the 2022 version of the OECD Transfer Pricing Guidelines, the CUP's requirements for closer similarities of characteristics between the products or services object to the comparability exercise (i.e., transaction) make the method problematic when applied to intangibles, more unique products or services, but not only[359]. Lack of precise publicly available information on, e.g., products or services characteristics, contractual terms, etc., also affects the comparability within a broad CUP's dynamics.

Both the RP and the CP methods face similar issues.

### *3.2.1.2. The Transactional Net Margin Method*

The introduction of the TNMM, in an international scenario, following the US' CPM, aimed, therefore, at *reconquering* the lost comparability by, in fact, *reimagining* it, as we have already noted.

The TNMM shifted the focus of comparability from individual transactions (as within the CUP) to broader profit-level indicators, in an attempt to provide for a *pragmatic* alternative to the lack of *strict* comparable. In this sense, according to the OECD

357 OECD, *Transfer Pricing and Multinational Enterprises. op. cit.*, § 11.

358 *Currently*, § 2.16 of the OECD Transfer Pricing Guidelines recognizes the limitations of the CUP method, which is further evidenced by the focus of the underlying section in the same OECD Transfer Pricing Guidelines on the limited applicability of the CUP to commodities, for example. We will see, as mentioned above, that the CUP is also applicable to financial transactions and in relations with economic valuation techniques, although these can be very problematic in practice. *See*: OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*, § 2.16

359 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*, e.g., § 6.116.

Transfer Pricing Guidelines, such comparability would be based on the contractual terms of the transaction, the functions performed by each of the parties to the transaction (including assets used and risks assumed), the characteristics of property or services and the underlying economic circumstances and business strategies[360].

*Objectivity* was, hence, gradually replaced by *subjectivity*.

As such, this *loosened* (or *broadened*[361]) comparability introduced challenges, especially regarding legal and tax certainty – the roots of our *randomization* problem. The added *subjectivity*, although allowing for the needed *flexibility* in the arm's length/transfer pricing *praxis*, culminated in increased *disputes*, thus contributing to the risks of double taxation and double non-taxation.

Based on our analysis of case law around the world, we see that these disputes fall into five main categories, encapsulating (or reflecting) the perceived weaknesses of current TNMM. These categories are summarized in the table below, where the cells within the second row express the main question associated with its underlying weakness, as often raised in case law.

**Table 1. The main perceived weaknesses/issues of the TNMM**

| Determination of the functional profile of the tested party | Adequateness of the choice of the cost-base (its composition) | Availability of reliable information on potential comparable data | Appropriateness of the adjustment made (if required) | Significance of the impact of economic cycles and market fluctuations |
|---|---|---|---|---|
| *Is the TNMM applicable to the case? If yes, to which potential set of comparable?* | *Is the TNMM applied on a correct basis?* | *Is the TNMM applied on available and reliable data?* | *Is the TNMM capable of (partially) overcoming the lack of available and reliable data?* | *Is the TNMM impaired by significant economic factors?* |

As shown above, TNMM's first issue relates to the actual understanding of the *functional and risk profile* of the tested party. Examples of the first (leading to a contested choice of method) will also be discussed below, within some of the most mediatic

360 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*, especially in § 1.36.

361 As referred to by e.g., Fris and Gonnet, "The State of the Art in Comparability for Transfer Pricing," *op. cit.*, 99.

transfer pricing cases in the last years, as the *Starbucks*[362] and to *Apple*[363].

Secondly, the adequate choice of the *cost-base* upon which the chosen profit level indicator ought to be applied (or the profitability be verified) has also led to several disputes. The importance of such an adequate choice is also discussed in the OECD Transfer Pricing Guidelines[364]. The segregation of both the tested-party and the (potential) comparable cost-base, as a way to (re)individualize transactions, can equally be problematic.

In 2024, in *Romania v. "Bottler S.R.L."*, Romanian tax authority challenged the taxpayer's adjustments to a TNMM comparability analysis which excluded large one-off expenses related to the revaluation of land and buildings and reorganization costs from its cost-base for the testing of the producing of soft drinks and purchasing of finished products for local distribution. The tax authority also argued for the inclusion/exclusion of potential comparable in the taxpayer's TNMM benchmark. The Supreme Court of Romania ruled for a middle ground between the parties[365].

Such issue was also raised by the EC in the mentioned *Starbucks*[366] case, as the EC's alternative claim.

Thirdly, we have the issue of the *lack of proper information* on the elements influencing the profit level indicator of potential comparable (incl. their respective cost-base composition). The TNMM heavily rely on external comparable and commercial databases, which are often the only available sources for benchmarking net profit margins[367]. Comparable found therein often lack segmented financial data, meaning that the available profitability metrics may not reflect the *actual* conditions of the specific transactions under review, but, rather, a tangle of different transactions/conditions combined. The financial performance of the entirety of companies is, henceforth, often used as a *proxy*, despite significant differences in business structures, operating conditions, and value drivers (i.e., the *functional profile*), which contaminates the *reliability* of the TNMM obtained *results*[368].

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362 European Commission (EC). *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks*. Official Journal of the European Union L 83/38, 29 March 2017.

363 European Commission (EC). *Commission Decision (EU) 2017/1283 of 30 August 2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) Implemented by Ireland to Apple*. Official Journal of the European Union L 187/1, 19 July 2017. *Vide* the systematic presentation of this issue in relation to the latter Apple case *in*: Nicole Robins, "The Tax State Aid Investigations, and the Role of Economic and Financial Analysis," *Finance and Capital Markets* 19, no. 5 (2017), (especially) 10.

364 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*. *op. cit*., especially in § 2.83 ff.

365 Înalta Curte de Casație și Justiție. *Romania v. A Bottler S.R.L.* Case No. 304/2024, January 2024.

366 EC, *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks*, *op. cit*.

367 As raised by, e.g.: Fleming Jr., Peroni and Shay. *op. cit*., 172.

368 This issue also relates to the functional profile discussions, as lack of adequate and reliable information can significantly impair the outcome of the functional analysis' comparability – creating a gap or discrepancy between the tested-party and its chosen comparable.

The consequent *misalignment* between the functional profile of the tested-party and its potential comparable (further highlighted by the lack of proper information) culminates in the TNMM's practical reality that, in many cases, the tested party operates under different economic conditions than its (potential) comparable. This leads either to a contested transfer pricing method's choice in both administrative and judicial procedures (e.g., under which the TNMM is deemed inappropriate due to a higher functional profile of the tested party, entitled to a more than routine profitability) or, at least, to disputes around the applied adjustments (to these differences), which are often imprecise, requiring subjective judgment calls – our fourth category in the table above.

These adjustments are frequently discussed in audits and litigations, especially in the absence of clearer roadmaps for the parties involved in the discussions[369], further eroding tax certainty.

In 2023, in *Peru v. Consorcio Minero Sociedad Anónima*, Peruvian tax authority challenged the adjustments made by the taxpayer's TNMM comparability analysis for intercompany sales of copper concentrate, as to account for accounting differences between the tested-party and the potential comparable. The Peruvian tax authority, hence, argued for the exclusion of the comparable, based on the argument that the differences in accounting methods were too significant to be reliably adjusted for. In this case, the Peruvian Supreme Court sided mostly with the taxpayer[370].

Other recent cases with similar challenges to comparable chosen and adjustments made are *Colombia v. Drummond LTDA*[371], from 2023, and *Korea v. "Semicon-sales"* [372], from 2022.

Fifthly, the TNMM is highly sensitive to economic cycles and market fluctuations, making it vulnerable to economic distortions. Unlike traditional methods that analyse prices at a transactional level, TNMM aggregates profit data *over a period*, meaning that results can be affected by short-term industry downturns, regional crises, or economic shocks (e.g., COVID-19, the war in Ukraine, etc.). This can result in companies being forced to justify deviations from benchmarks that are influenced by temporary external factors rather than genuine transfer pricing mismatches. The inability to consistently adjust for such externalities weakens the reliability of TNMM and increases the likelihood of tax adjustments based on arbitrary comparisons. In the end, taxpayers and tax authorities alike have to resort to simplified mechanisms, in a trade-off attempt to secure legal and tax certainty (in many cases, not without disputes).

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369 Despite the provision of certain conditions for that, in the OECD Transfer Pricing Guidelines. *Vide*, OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*, especially in §§ 2.74-2.81.

370 Peru v. Consorcio Minero Sociedad Anónima, Casación No. 19941-2023, Corte Suprema de Justicia de la República, November 2023.

371 Consejo de Estado. *Colombia v. Drummond LTDA*. Case No. 25000-23-37-000-2013-01285-01 (24727). June 2023.

372 Tax Court. *Korea v. Semicon-sales*. Case No. 2020-서-2311. June 2022.

In *Argentina v. Volkswagen Argentina S.A.*, Argentinian tax authority challenged the comparison/comparability between a profit level indicator of *Volkswagen Argentina S.A.*, calculated as an average of the results obtained in the period between 1999-2001, and the same profit level indicator obtained from comparable results' average for the period 1998-2000, which did not reflect the abnormal 2001 results, following a serious economic crisis in Argentina in that year[373].

Despite the issues illustrated, the wide acceptance and adoption of the TNMM within virtually all ALS space *variants*, as shown by the variety of geographies selected in the exemplificative cases collated above, for, at least, the last two decades[374], paired with the broad understanding of this method's compatibility with the ALS, thus reveal that the resort to *strict* comparable (as within the traditional methods) is *not* – as we have already stated – a *necessary* element to the arm's length *core*.

This conclusion, however, cannot be misinterpreted to mean that current TNMM comparability variant, although pragmatically important in the ALS *time evolution*, is *sustainable*, given all the weaknesses presented above.

The issues identified within this Section lead to the phenomenon of the *randomization* of the arm's length results, as we will turn to in Section 3.2.2 below. We will also trace parallels between our highlighted issues categories and the proposed solutions to reimagine the ALS, both the ones currently on the table and our owns.

#### *3.2.1.3. The Profit Split Method*

The TNMM is not the only transactional transfer pricing method contributing to the phenomenon of *randomization* – as so is the application of the PSM.

Under the PSM, as we have discussed, the profits derived from transactions (*conditions*) between related parties is shared (*split*) based upon a *reasonable approximation* of a profit division that independent enterprises should have expected to make from engaging in comparable transactions (i.e., in a *comparable* profit split)[375]. In the more frequent than not cases of inexistence of comparable, the analysis to be caried out within the PSM application must be founded on a functional analysis approach, similarly as we have highlighted for the TNMM, especially minding the relative contributions of the parties[376].

The 2022 version of the OECD Transfer Pricing Guidelines state, in *verbis*:

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373 Corte Suprema de Justicia de la Nación. *Argentina v. Volkswagen Argentina S.A*. Case No. CSJN 13/08/2024 (TF 30954-I), August 2024.

374 As commented in, e.g., Fris and Gonnet, *op. cit*., 99.

375 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*. *op. cit*., especially in § 2.114 ff. As also discussed by, Vikram Chand and Sagar Wagh, "The Profit Split Method: Status Quo and Outlook in Light of the BEPS Action Plan," *International Transfer Pricing Journal* 21, no. 6 (2014).

376 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*. *op. cit*., especially in § 2.125 ff. Chand and Wagh, " *op. cit*., 403 ff.

> "(…). The transactional profit split method is particularly useful when the compensation to the associated enterprises can be more reliably valued by reference to the relative shares of their contributions to the profits arising in relation to the transaction(s) than by a more direct estimation of the value of those contributions."[377]

The even further added flexibility, which streams from the OECD's paragraph above, nevertheless, raises concerns in terms of the subjectivity in assessing said relative shares of contributions, which leads to the application of a significant *judgement* of the parties involved, as recognized by the OECD itself[378].

As no benchmark would be directly available, the variables to the PSM, hence supposedly reflecting those shares of contributions (i.e., mostly the profit driving elements and their allocation keys) would have to be based on an even further stretched comparability notion, founded on what would be *economically justified*[379]. Thus, the PSM can be applied even when comparable (in a *traditional* or even a *TNMM-expanded* understanding of the expression) does not exist. This then justifies the adoption of the PSM as another *pragmatical* solution to the transfer pricing *praxis*[380].

In our view, the underlying notion of what is *economically justified*, in the selection of the elements to the profit split application, can only make sense when analysed through the lens of our (light) *enterprise approach* range in the arm's length rationale *continuum*, due to our already discussed inadequacy of an unabridged levelling of the behaviour of MNEs with those of fully independent parties. The adoption of the economically justified idea thus further reinforces our previously made arguments in favour of a more systematic introduction of enterprise approaches elements in a reimagined arm's length *variant*.

The PSM, nevertheless, was not broadly adopted right after its implementation in many jurisdiction's legislations, between the 1990's and the early 2000s', scenario which lasted, *at least*, all the way until the early 2010's, as noted by Chand and Wagh[381]. Only in light of the already discussed OECD work on the tail of the BEPS Project development, the PSM was expected to be more widely applied/adopted by different jurisdictions[382].

The more frequent use of the PSM in an international context thus highlighted its weaknesses and insufficiencies, evidenced by case law, as we will further turn to, but

377 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit*., especially in § 2.114.

378 *Ibid.*, especially in § 2.123. We will turn back to this specific paragraph when discussing the mentioned formal/compliance issues associated with current PSM dynamics.

379 Chand and Wagh, *op. cit*., 403.

380 Nataliia Guzenko, "Recent Case Law on the Application of the Profit Split Method," *International Transfer Pricing Journal* 31, no. 3 (2024), 136.

381 Chand and Wagh, *op. cit*., 402-403.

382 *Ibid.*, 402-403.

also discussed in the literature[383], which presents some of the main issues on the way to an effective application of the PSM.

Said issues associated with the PSM application not only relate to the insufficiency of the method, from a *substance* perspective, as we will discuss within this Section, but also from a formal/*compliance* perspective. Relevant points, such as the method's high costs of implementation and administration and burdensome information gathering/presenting efforts necessary during audits and overall litigations[384] will be discussed, from a broader arm's length/transfer pricing perspective, under our Section 3.3 below, when discussing the challenges associated with the arm's length core's *compliance requirements*.

The main issues related to the PSM we will now turn to, streaming from the method's overall complexity and high subjectivity[385] are presented in the table below. These issues have led to inconsistent application of the PSM and to a distancing from tax and legal certainty, thus contributing to increased arm's length/transfer pricing litigation.

**Table 2. The Main Perceived Weaknesses/Issues of the PSM**

| Determination of the functional profile of the parties | Determination of the elements responsible for the profit split | Determination of the weight of each of the elements responsible for the profit split |
|---|---|---|
| *Are the contributions of the parties valuable and unique? If yes, is the PSM applicable to the case?* | *Are the elements used to split the profit adequate and reliable?* | *Are the elements used to split the profit adequately weighted?* |

Revolving around the first issue, in *France v. Engie SA*[386], the French tax authority argued that Engie SA's applied transfer pricing methodology for transactions with related parties, relating to spot purchases and sales of liquefied natural gas, based on the taxpayer's allegedly limited functional profile, was erroneous. As such, the French tax authority aimed for a recharacterization of Engie SA's functional profile to that of a more predominant role, thus arguing for additional profit to be allocated to it, based on the application of a PSM. The court, herein, sided with the taxpayer.

In *Slovakia v. Illichmann Castalloy s.r.o.*[387], the situation was actually the *opposite* as in *France v. Engie SA* above. The Slovakian tax authority disagreed with the application of a PSM to *Illichmann Castalloy s.r.o.* related parties' activities in the production of

383 As in, e.g.: Guzenko, *op. cit.*, 135-143.

384 *Vide*, Guzenko, *op. cit.*, 135

385 *Ibid.*, 135.

386 France v. SA Engie, Cour administrative d'appel de Paris, 9th Chamber, Case No. 21PA01277, 27 June 2024.

387 Správny súd v Bratislave. *Slovakia v. Illichmann Castalloy s.r.o.* Case No. BA-1S/111/2019, 9 August 2024.

aluminium castings, which ultimately led *Illichmann Castalloy s.r.o.* to incur in significant losses in Slovakia during the period under review. Alternatively, the Slovakian tax authority defended that *Illichmann Castalloy s.r.o.* did not perform any decision-making functions, nor controlled any significant risks. Hence, the Slovakian tax authority stated that the taxpayer would have to be remunerated based on the application of a TNMM, streaming from the taxpayers supposedly limited risk manufacturer functional profile. Like in *France v. Engie SA*, the court rules mostly in favour of the taxpayer.

Finally, *India v. Toyota Kirloskar Auto Parts Private Limited*[388] represented yet another victory for the taxpayer, as in our previous examples. In this case, the Indian tax authority did not agree with Toyota Kirloskar Auto Parts Private Limited's choice of PSM to testing the aggregated payment of royalty with the transaction of manufacturing with a related party. The court ruled that Toyota Kirloskar Auto Parts Private Limited did not make any unique contribution to the transaction and that the PSM could not be applied to the case.

The choice of split factors, as the second point within our Table 2 above, has also been disputed in case law.

In *Italy v. SIOT S.p.A.*[389], the latter operated oil pipelines across Italy, Austria and Germany, with both an Austrian and a German subsidiary (related parties). To allocate profits derived from the oil pipelines' activities between the entities involved, *SIOT S.p.A*. applied a PSM, under which kilometres of pipelines was chosen as a determining splitting element. The Italian tax authority challenged the choice of the split factor, thus pledging for the inclusion of maintenance costs (as, in the case, *SIOT S.p.A*. incurred in a much higher proportion than its subsidiaries) and electricity used in the formula. Finally, the weights of the split factors can also be scrutinized by the tax authorities.

Streaming from these *set*s of cases, it clear is that the tensions between *flexibility* (as a product of the further stretched notion of comparability) and *legal certainty* will always exist. Fully covering for the later would deem the flexibility inexistent, hence creating a significant obstacle to the application of the ALS/transfer pricing methods in contemporary economic reality (since the 1960's). As we will further discuss below, eliminating the inherent flexibility of the transactional methods could also be translated into an undesirable undermining of the light enterprise approach view in a *reimagined* arm's length *variant*. Alternatives to be presented must, therefore, attain for a feasible compromise, such as in simplified approaches (incl. formula-based alternatives).

Finally, an important note to our reader. Under our TNMM and PSM discussions, the issue (and underlying understanding) of *comparability* is found in a different meaning of the term than the ones we have already used under Chapter 3. Above, we

388 Income Tax Appellate Tribunal – Bangalore. *India v. Toyota Kirloskar Auto Parts Private Limited*. Case No. IT(TP)A No. 1915/Bang/2017 & 3377/Bang/2018, 18 March 2020.

389 Corte di Cassazione. *Italy v. SIOT S.p.A*. Case No. Sez. 5 Num. 11837, 18 June 2020.

have framed comparability from a *market*/*operational* logic, within which a potentially comparable transaction *does* exist, been the non-comparability a consequence of the intrinsically different market/operational *rationale* that might have been between the MNE and independent parties. An example of that would be a *disregarded condition*, under a light enterprise approach view of the ALS, even though that *condition* (or transaction) would normally be *regarded*/priced in an independent parties' scenario.

Under the TNMM and PSM assessments, the *condition* (or transaction) either does not exist (i.e., due to its uniqueness) or, because of significant functional profile differences or lack of adequate information, cannot be satisfactorily compared, without the resorting to a *panacea* of subjective adjustments.

Naturally, as we will see ahead, the set of potential alternatives/solutions to this second problem will be different than the ones we have introduced – under the *rational business conducts* – for the first. Before, nevertheless, we will turn to the analysis on how this second lack of comparability understanding has led to the *randomization* of the arm's length results.

### *3.2.2. The 'Randomization' of the Arm's Length Result*

#### *3.2.2.1. Approximation vs. 'Randomization'*

The issues associated with the transfer pricing methods, especially the *transactional* methods as presented above, all lead to a high level of *unpredictability* in the determination of the (arm's length) results[390]. They lead to a practical *non* (or, at least, *less*) systematic application of the ALS, with the increasing role of subjective judgement calls and, consequently, to *volatility* and impaired tax and legal certainty. In this sense, results are tailored to the interests of the different parties applying/assessing the transfer pricing methods rather than conceived to arrive at outcomes which would have been obtained by unrelated parties had them be in a comparable scenario. This process is what we define as the *randomization* of the arm's length results[391].

Differently, the idea of *approximation* (to which we will confront our *randomization*) is not only a tolerable, but also important, systematic, part of the transfer pricing *praxis*.

Since the early stages of the *time* evolution of the ALS, it's been understood that the transfer pricing establishment/verification process would rarely arrive at a *single* result, this also holds true in the application of any of the arm's length practical expressions (i.e., methods). Thereby, the justification for the resorting to an arm's length *range* in

390 The traditional methods earlier issues rather mostly lead to their insufficiency in a more literal sense of inapplicability.

391 While the traditional methods, and especially the CUP, do not directly contribute/culminate in this randomization process, it indirectly (although decisively) does so. As we have stated again at the beginning of our previous Section, the TNMM and the transactional methods in general were born as an attempt to cope with the more literal insufficiency of the CUP. *See footnote above*.

most cases. This is clearly reflected in the wording of the 2022 OECD Transfer Pricing Guidelines, in *verbis*:

> "In some cases it will be possible to apply the arm's length principle to arrive at a single figure (e.g. price or margin) that is the most reliable to establish whether the conditions of a transaction are arm's length. However, because transfer pricing is not an exact science, there will also be many occasions when the application of the most appropriate method or methods produces a **range of figures all of which are relatively equally reliable**. In these cases, differences in the figures that comprise the range may be caused by the fact that in general the application of the arm's length principle only produces an **approximation** of conditions that would have been established between independent enterprises. It is also possible that the different points in a range represent the fact that independent enterprises engaged in comparable transactions under comparable circumstances may not establish exactly the same price for the transaction.[392]" (*Our highlights*)

Starting from our second highlight above, the OCDE in itself recognizes, as a consequence of that *range*, that the ALS is aimed at producing an *approximated* result. This is perceived as a product of the diversity of the behaviours that independent parties can potentially take in face of comparable circumstances. The approximation exercise is, therefore, not, *per se*, contrary to the ALS results' core. It is, rather, foreseen and widely used in the ALS *praxis*.

The setting of *boundaries* to the underlying notion of approximation is, nevertheless, necessary, and can also be understood as a concern of the OECD. In our first highlight above, it is understood that the arm's length result's *range* (encapsulating the idea of approximation) must provide figures all of which are relatively equally reliable[393]. Hence, e.g., a TNMM derived range, comprised of figures obtained from problematic comparable (*vide* our comments above in this Section), would *not* be an expression of the accepted approximation. Likewise, the application of a PSM based on non-adequate and unreliable elements of split (and their underlying weights) shall not lead to an approximate arm's length result.

Still, different understandings of the approximation result can be found in different ALS *space variants*.

Some tools are foreseen by the OECD Transfer Pricing Guidelines to reduce the size (i.e., broadness of the approximation) of the comparable results range. Firstly, the OECD proposes the use of statistical tools to reduce the range's wideness, with a central results tendency (i.e., an interquartile range)[394]. Although the OECD suggests the use of statistical tools as an option to specific cases, some jurisdictions, e.g., Estonia[395],

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392 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit*., § 3.55.

393 *Ibid.*, § 3.55.

394 *Ibid.*, § 3.57.

395 Republic of Estonia, *Methods for Determining the Value of Transactions Conducted Between Associated Persons*, RTL 2006, 81, 1506, as amended by RT I, 23.12.2021, 4, Art. 2(6).

have implemented the use of interquartile ranges as a legal requirement. Additionally, the OECD Transfer Pricing Guidelines also suggests the use of more than one method as to arrive at an overlapping range, *theoretically* more reliable[396].

These are not efficient to comprehensively tackle the problem, especially when the comparable used (TNMM) and the elements used (PSM) are contaminated with the problems we have analysed within the Sections above. Adjusting a set which is intrinsically contaminated would not make it reliable.

We have to trace a line of what sort of misapplications of the ALS would be under the *tolerable* level of approximation (broadness of range) inherently related to the diverse behaviour of independent parties and the acceptable way towards the light enterprise approach end of our presented *continuum* and to the inseparable subjectivity to the own nature of the transfer pricing methods. This line is most certainly not an easy one to be drawn, although its contours might inevitably carry some blurriness.

*Random* results, therefore, cannot be called arm's length results. Random results although theoretically able to mimic those which would have been obtained by independent parties, they do not (or, rather, cannot) be said to have the intend to achieve said mimicking. For that reason, random results cannot be deemed compatible with our drawn arm's length result's *core*.

Hence, it is possible to conclude that current insufficiency of the transfer pricing methods, and especially the TNMM and the PSM, in many cases lead not to approximate results, as *per* the boundaries above discussed, but rather to *random* results, uncapable of efficiently translating arm's length compliance. Such results lead to the lack of legal and tax certainty and to increased transfer pricing related disputes.

### *3.2.3. The Barriers to the EU Fundamental Freedoms*

#### *3.2.3.1. The Lack of Objective and Verifiable Criteria*

As we have already discussed above, the case law of the EU presents key elements to the *justification* assessment of the *a priori restrictive* ALS. *SGI*'s para. 71 encapsulates these elements:

> "National legislation which provides for a consideration of **objective and verifiable elements** in order to determine whether a transaction represents an artificial arrangement, entered into for tax reasons, is to be regarded as not going beyond what is necessary to attain the objectives relating to the need to maintain the balanced allocation of the power to tax between the Member States and to prevent tax avoidance where, first, on each occasion on which there is a suspicion that a transaction goes beyond what the companies concerned would have agreed under fully competitive conditions, the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide evi-

396 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*, *op. cit.*, § 3.58.

> dence of any commercial justification that there may have been for that transaction."[397] (*Our highlight*)

We have previously analysed *SGI*'s meaning of the 'any commercial justification' element, within our arm's length *rationale* assessment and will turn to the ALS capabilities of fulfilling its roles as to 'maintain the balanced allocation of the power to tax between the Member States and to prevent tax avoidance' and to its current 'undue administrative constraints' ahead. The above highlight on the 'objective and verifiable criteria' will be our subject of analysis, in relation to the insufficiency of the transfer pricing methods and how they reflect in/contribute to the *randomization* problem.

Although the *SGI* analysis is based on a legislation which is *deemed* to provide for these objective and verifiable elements, the CJEU therein in any way clarified its understanding of the terms. In order to seek for such an understanding, one must resort to AG Kokott's opinion to the case[398], which brings back the contributions of the CJEU's decision on the already mentioned *Thin Capitalization Group Litigation*[399]. Paragraph 81 of the latter states that:

> '[…] [T]erms which do not correspond to those which would have been agreed upon at arm's length constitutes, for the Member State in which the […] company is resident, an objective element which can be independently verified in order to determine whether the transaction in question represents, in whole or in part, a purely artificial arrangement, the essential purpose of which is to circumvent the tax legislation of that Member State."[400]

This paragraph can be said to be inspired or, at least, influenced by AG Geelhoed's opinion to the case, in *verbis*:

> "It seems to me that the arm's length principle, accepted by international tax law as the appropriate means of avoiding artificial manipulations of cross-border transactions, is in principle a valid starting point for assessing whether a transaction is abusive or not. To use the reasoning of the Court developed in the indirect tax sphere and other non-tax spheres, the arm's length test represents in this context an objective factor by which it can be assessed whether the essential aim of the transaction concerned is to obtain a tax advantage. (…)."[401]

The first part of this paragraph (as collated above), as well as the other case law (opinions to them included) discussed refer to the fact that an objective element is

397 CJEU, *Société de Gestion Industrielle v. Etat belge*, *op. cit.*, §71.

398 Juliane Kokott, Opinion in *Société de Gestion Industrielle (SGI) v. État belge*, *op. cit.*, § 68.

399 ECJ, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, *op. cit.*, § 81-82.

400 *Ibid.*, § 81.

401 Opinion of Advocate General Geelhoed, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, *op. cit.*, § 66.

needed, capable of been independently verified, to justify the restrictive nature of the ALS as an anti-abusive instrument (connected to the ALS' roles). For us, at this point, it is actually more important to discuss a second (and preceding) point, on whether current ALS OECD *variant* is capable of actually been this objective element. The second part of AG Geelhoed's para. 66 leads us towards that direction:

> "(…) Moreover, it is in my view valid, and indeed to be encouraged, for Member States to set out certain **reasonable criteria** against which they will assess compliance of a transaction with the arm's length principle, and in case of non-compliance with these criteria for them to presume that the transaction is abusive, subject to proof to the contrary."[402] (*Our highlight*)

Lack of reasonable criteria is translated in lack of actually *verifiable* deriving results, which ends up culminating in our described *randomization*.

Additionally, AG Geelhoed's idea on 'subject to proof of the contrary' is very important to our considerations and very much aligned with our comments on the need for a light enterprise approach/ rational business conducts mindset within the arm's length *praxis*. We shall connect the dots under our reimagination proposal frameworks, within Chapter 4 below.

Finally, our views align with his when concluding the scrutinized paragraph 66:

> "(…) The setting out of such criteria is, to my eyes, in the interests of legal certainty for taxpayers, as well as workability for tax authorities. This approach is to be contrasted, for example, with the use of a single fixed criterion to be applied in all cases — such as a fixed debt-equity ratio — which does not allow other circumstances to be taken into account."[403]

The notion of what constitutes the objective and verifiable criteria was also very recently discussed by the CJEU, in its 2024 decision on *X BV*[404].

Paragraphs 66 and 74 of the mentioned case reinstated the understanding which was kick-started with our collated AG Geelhoed's opinion to *Thin Capitalization Group Litigation*. We will shortly turn back to the *X BV* case, and dully present its background, when discussing the inefficiencies of the arm's length roles, under Section 3.4 below.

In conclusion, we understand that the insufficiencies of the transfer pricing methods, from a general/international perspective, does likely hatch in an arm's length legislation which fails to provide for objective and actually verifiable criteria. Hence, we believe such a legislation (i.e., arm's length *variant*) should fail the justification (*proportionality*) test of the CJEU and would have to be regarded contrary to the fundamental freedoms/freedom of establishment, as enshrined in the TFEU.

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402 Opinion of Advocate General Geelhoed, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, *op. cit.*, § 66.

403 *Ibid.*, § 66.

404 Court of Justice of the European Union (CJEU). *Judgment of the Court (First Chamber) of 4 October 2024 – X BV v. Staatssecretaris van Financiën* (Case C585/22), ECLI:EU:C:2024:812.

As we will see right below, some targeted/individual measures are increasingly used to attain for such lost *legal certainty*. They still do not escape the scrutiny of the EU Law, although imposed trough a different angle: the prohibition of (fiscal) State aid within the EU.

### *3.2.4. The EU State Aid Issues*

#### *3.2.4.1. The Advance Pricing Agreements*

Current OECD ALS *variant* – also reflected in many domestic *variants* – foresees the application of rather narrow, targeted (*individual*) measures to reduce the instability arising from the increasing complexity and subjectivity of the transfer pricing methods, leading to their above discussed perceived insufficiencies. These measures are often called advance pricing arrangements (or agreements) (**'APA'**) and are prescribed by the OECD Transfer Pricing Guidelines in themselves[405]. An APA is "an [*individual*] arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing *for those transactions* over a fixed period of time"[406] (*our addition and highlight*).

Although recognizing the importance of the APA, we firmly believe that solely targeted (*individual*) measures are not adequate to tackle our identified insufficiency issues, as they are not enough to provide for the missing *objective* and *verifiable* criteria in transfer pricing.

As we will turn to below, APAs have also been used as a tool to promote tax avoidance and harmful tax competition, which is especially highlighted in an EU context. The commanding statement of an APA, thus, gives not only room for the identified issues, but also authority to the manipulation of our highlighted transfer pricing methods' weaknesses. Misapplication of the APA instruments, hence, can (and, as we will see, frequently does) lead to *random* results, at non-arm's length.

All in all, we believe that APAs shall still work as a subsidiary measure to the application of the more general (broader) tools, as we will shortly turn to. In such a scenario, the importance of the APA must be safeguarded although its need shall be reduced and its misuse framed/limited to less cases/situations. This should also contribute to the APA's sustainability in the EU[407].

The Section below will present how these individual measures, beyond the issues briefly mentioned herein (and the inability to provide for the missing objective and

405 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*, *op. cit.*, § 4.134 ff.

406 *Ibid.*, § 4.134.

407 Thus, preventing the potential loss of relevance and legitimacy of APAs within the European Union, as highlighted in: Abhishek Padwalkar, "Brewing Transfer Pricing: Unravelling the Starbucks Case," *International Transfer Pricing Journal* 31, no. 4 (2024), 205-206.

verifiable criteria) can lead to selective advantages, in an EU (fiscal) State-aid prohibition scenario, and how this is related to the *randomization* of the (arm's length) results.

#### *3.2.4.2. The Selective Advantages under the 'Randomization'*

The prohibition of State aid, originally part of *competition* law, has being increasingly related (or applied) to tax matters[408]. It is safe to establish that the EC, in recent years, has found in the prohibition of (fiscal) State aid a powerful tool to challenge Member States' tax *measures*, especially in relation to the underlying deficiencies of current ALS *variants*, given the absence of more direct tools in the TFEU. For us, although fiscal State aid might be conferred trough different means, the focus shall be on provisions (or, rather, *targeted measures*) individually addressed to particular taxpayers (also known as *targeted* State aid[409]), such as tax rulings and, even more specifically, those related to the ALS, namely, the above presented APA.

This growing EC's scrutiny kick-started with the investigations leading to the decisions, issued in October 2015, on the *Starbucks*[410] and the *Fiat*[411] cases, the content of which was later mirrored in the publication of the EC 2016 Notice[412], a document already presented within our *time* evolution assessment under Chapter 2. As we have mentioned therein, the EC 2016 Notice reveals the understanding that the ALS is as an *intrinsic* tool in assessing whether a tax measure constitutes State aid under Articles 107 and 108 TFEU[413], *regardless* of domestic implementation of (an) ALS in the Mem-

408 As presented in, Alexandra Miladinovic, *op. cit*., 103-104.

409 *Ibid.*, 103-104.

410 EC, *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks. op. cit*.

411 European Commission (EC). *Commission Decision (EU) 2016/2326 of 21 October 2015 on State Aid SA.38375 (2014/C ex 2014/NN) Implemented by Luxembourg to Fiat*. Official Journal of the European Union L 351/1, 22 December 2016.

412 EC, *Commission Notice on the Notion of State Aid as Referred to in Article 107(1) of the Treaty on the Functioning of the European Union. op. cit*.

413 *Ibid.*

ber State's legislation at stake[414].

As such, the EC evaluates whether transfer pricing measures or arrangements confer a *selective advantage* on a company by leading to deviating *results* from those that independent undertakings would be expected to achieve. Following its 2016 Notice, the EC applies the understanding that its ALS *variant* must be the benchmark against which to determine whether intra-group transactions result in an undue economic benefit (via a transfer mispricing), in comparison to other undertakings, subject to the domestic corporate income tax of a Member State[415]. Therefore, if an APA or similar measure leads to a non-arm's length outcome (*result*), favouring a specific company or group, it may always constitute illegal State aid under the eyes of the EC.

It is clear, therefore, that the publication of the EC 2016 Notice (and its subsequent intensive application) highlighted the importance of the ALS in current EU *praxis* and, thus, also helped us in justifying our research's premise of proposing only '*at* arm's length solutions'.

Our focus within this Section, nevertheless, is neither to debate the *status* of the ALS in Europe nor the *EC's competence* in determining such status (e.g., of an intrinsic *principle* of EU Law)[416], although these are usually the focus of most of what was written about those EC investigations/decisions. We will also not turn to the specific discussions on the necessary steps for the configuration of a State aid.

Alternatively, our efforts lie in understanding *how* current transfer pricing methods, as the practical expressions of the ALS, have proposedly being (mis)applied by its operators (i.e., taxpayers and tax authorities alike), in the attempt to blur the limits of the arm's length compatible *results* and to confer undue selective advantages, fostering aggressive tax competition. We shall also turn to how all of this have contributed to the increasing scrutiny by the EC in the decade following its 2016 Notice publication.

Recent case law has (*consistently*) shown that such selective misapplication *streams* (or *benefits*, as one might argue) from the increasing complexity (and underlying

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414 The EC, hence, understands that, as companies, members of an MNE or standalone alike, are subject to corporate income taxes in a given Member State, the corporate income tax rules must be regarded as the reference system, and not an *eventual* arm's length/transfer pricing domestic legislation. This understanding is clear from all the cases under analysis within this section: EC, *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks. op. cit.*, § 232; EC, *Commission Decision (EU) 2016/2326 of 21 October 2015 on State Aid SA.38375 (2014/C ex 2014/NN) Implemented by Luxembourg to Fiat. op. cit.*, § 194; EC, *Commission Decision (EU) 2017/1283 of 30 August 2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) Implemented by Ireland to Apple. op. cit.*, § 228, and European Commission (EC). *Commission Decision (EU) 2018/859 of 4 October 2017 on State Aid SA.38944 (2014/C) (ex 2014/NN) Implemented by Luxembourg to Amazon*. Official Journal of the European Union L 153/1, 18 June 2018, § 587. It is not within our scope, nevertheless, to discuss the appropriateness of the choice of the reference system by the EC.

415 EC, *Commission Notice on the Notion of State Aid as Referred to in Article 107(1) of the Treaty on the Functioning of the European Union. op. cit*.

416 Process some call as a "harmonization of direct taxation through the backdoor", e.g.: Alexandra Miladinovic, *op. cit.*, 105.

subjectivity) added to the ALS *praxis* (trough the evolution of transfer pricing methods), intrinsically related, therefore, to our discussed inefficiencies and insufficiencies of the transfer pricing methods. Hence, the tension between the ideas of *approximation* and *randomization* of the arm's length results gains even more importance. While the first is an inherent part of the arm's length result's core, as discussed above, the second is a representation of a non-arm's length result – hence, potentially subject to (fiscal) State aid prohibition within the EU.

Importantly, what we have called *approximation* (or yet *tolerable level of approximation*) we will herein translate into the idea/expression of *reliable approximation*, as widely used in the recent arm's length (fiscal) State aid cases within the EU courts. This expression was used by the EC in its decisions in the e.g., *Starbucks*[417], *Fiat*[418], *Apple*[419] and *Amazon*[420], in the previous decade.

Although widely used as a reference to the establishment of what would be within an arm's length behaviour framework in the mentioned cases, the EC did not expressly mention what it understood to be said reliable approximation. The EGC, though, already when assessing *Starbucks*, understood the idea of reliable approximation to mean that there would only be a *selective advantage* (for us, now, meaning a deviation from the ALS' *results*) if "(…) the variation between the two comparables goes beyond the inaccuracies inherent in the methodology used to obtain that approximation"[421].

Hence, a reliable approximation would mean the range of results obtained, considering only the inherent inaccuracies in the methodology used to obtain that approximation, while still retaining *reliability* and *predictability*.

As the mentioned cases will guide our remaining considerations in this Section, a short background on them and on their implications is imperative.

***Starbucks***

In *Starbucks*, the EC scrutinized an APA concluded between the Netherlands and Starbucks Manufacturing EMEA BV (**'SMBV'**), to evaluate whether the transfer pricing methodology endorsed therein provided for that reliable approximation of the arm's length outcome (*result*)[422]. SMBV was responsible for the roasting of coffee beans

417 EC, *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks*. *op. cit*., § 263 and others.

418 EC, *Commission Decision (EU) 2016/2326 of 21 October 2015 on State Aid SA.38375 (2014/C ex 2014/NN) Implemented by Luxembourg to Fiat*. *op. cit*., § 227 and others.

419 EC, *Commission Decision (EU) 2017/1283 of 30 August 2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) Implemented by Ireland to Apple*. *op. cit*., § 255 and others.

420 EC, *Commission Decision (EU) 2018/859 of 4 October 2017 on State Aid SA.38944 (2014/C) (ex 2014/NN) Implemented by Luxembourg to Amazon*. *op. cit*., § 399 and others.

421 European General Court (EGC), *Judgment of the General Court (Seventh Chamber, Extended Composition) of 24 September 2019 – Kingdom of the Netherlands v. European Commission (Case T-760/15); Starbucks Corp. and Starbucks Manufacturing Emea BV v. European Commission (Case T-636/16),* ECLI:EU:T:2019:661, §152.

422 EC, *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks*. *op. cit*., § 155 and following.

and the supply of roasted coffee and other related products to Starbucks shops within the EMEA region[423]. In order to conduct its business activities, SMBV sourced green coffee beans from Starbucks Coffee Trading SARL (**'SCTC'**), a Swiss related party[424]. As SMBV did not own the necessary intangibles to its roasting and distributing activities (i.e., know-how and trademarks), these were licensed from another related party, Alki LP (**'Alki'**), a tax resident in the United Kingdom, for which a royalty fee was paid[425].The first transaction was priced using a TNMM method, while the second was priced as a percentage of SMBV sales[426].

The transfer pricing model endorsed by the analysed APA was centred on the choice, and application, of a TNMM, ensuring a routine profitability to SMBV, based on its established low risk/limited profile as a reseller. The cost base upon which the profitability was calculated (and benchmarked) comprised operating expenses, hence neither including the green coffee beans costs nor the royalty payments to Alki[427]. This arrangement validated a consistently low profitability in SMBV, as, beyond the routine remuneration applied to its cost base, the company incurred in the two above identified significant costs.

The centre of the EC's assessment was, then, the correctness of the TNMM application, raising points closely related to the ones we have scrutinized above (i.e., the determination of the functional profile of the tested party).

As such, the EC argued that the TNMM might not have been the most appropriate method to evaluate the arm's length nature of the highlighted transactions. Specifically, the Commission suggested that CUP method would have been more suitable for evaluating the arm's length nature of both the purchase of coffee beans and the royalty fees paid by SMBV[428], as SMBV would have a more complex and elevated functional profile, thus invalidating the appropriateness of the chosen method[429].

As subsidiary arguments to its claims, the EC also argued, besides other considerations around the choice of the tested party and the profit level indicator, that the

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423 EC, *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks. op. cit.*, § 49 ff.

424 European Commission (EC). *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks. op. cit.*, § 50.

425 *Ibid.*, § 48.

426 *Ibid.*, § 56 and 288.

427 European Commission (EC). *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks. op. cit.*, e.g., § 59 and 316. For an additional assessment of SMBV transfer pricing model, as discussed in the EC decision under scrutiny, *see*: Padwalkar, *op. cit*.

428 EC, *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks. op. cit.*, § 290 ff.

429 *Ibid.*, § 362 ff. This also highlights the importance of the accurate delineation of the transaction to be tested, based on actual functional profile of the parties involved. OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*, § 2.125 ff. Also discussed in Padwalkar, *op. cit.*, 201-202.

cost-base as determined by SMBV was inadequate, as it did not include certain expected costs, which, consequently, were not compensated/remunerated, thus further contributing to SMBV's allegedly artificial reduction of its taxable profits in the Netherlands. Finally, the EC also subsidiarily contested the adjustments made to SMBV's comparability exercise within the application of the TNMM, claiming for the inadequacy of the adjustments made[430].

The EGC annulled the contested decision, mostly on the grounds of the fact that the EC failed to demonstrate (*prove*) the existence of the selective advantage conferred by the Netherlands to SMBV trough the disputed APA (in our terminology, the *randomness* of the result). As such, the EC failed, in the eyes of the EGC, to demonstrate that the application of the transfer pricing methods by SMBV led to the achievement of a reliable approximation of the arm's length results[431].

The situation was different in *Fiat*[432] and in *Apple*, although the latter only after the CJEU's assessment[433]. After analysing our remaining proposed cases, we will turn to the reflexes of the *weight* of the *burden of proof* argument in the way the cases were decided and how it relates to our *randomization* problem.

***Fiat***

*Fiat* relates to the relations between Fiat Finance and Trade Ltd. (**'FFT'**), a tax resident in Luxembourg, and its parent company, Fiat Chrysler Automobile NV (**'FCA'**), which were subject to an APA with the Luxembourgish authorities. FFT acted as an intra-group financing company, being the provision of loans and financial services to its related parties the core of its business operations, as the group's treasury centre for Europe[434]. The EC's investigation and underlying decision scrutinized both loan and treasury services transactions, as objects to the mentioned APA with the Luxembourgish authorities[435].

FFT based the verification of its related party financing transactions' arm's length nature on the application of a TNMM[436]. As in *Starbucks* (and in relation to our first point under Section's 3.2.1.2), the EC contested FFT's choice of method. The EC argue that the methodology chosen was fairly complex and artificial, given the existence of a

430 EC, *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks*. *op. cit*., § 401 ff.

431 EGC, *Judgment of the General Court (Seventh Chamber, Extended Composition) of 24 September 2019 – Kingdom of the Netherlands v. European Commission (Case T-760/15); Starbucks Corp. and Starbucks Manufacturing Emea BV v. European Commission (Case T-636/16), op. cit*., § 559-561.

432 European General Court (EGC), *Judgment of the General Court (Seventh Chamber, Extended Composition) of 24 September 2019 – Grand Duchy of Luxembourg v. European Commission* (Case T-755/15), *ECLI:EU:T:2019:670*, § 430.

433 CJEU, Judgment of the Court (Grand Chamber) of 10 September 2024 – Case C-465/20: *European Commission v. Ireland and Others*, *op. cit*., § 253-259.

434 EC, *Commission Decision (EU) 2016/2326 of 21 October 2015 on State Aid SA.38375 (2014/C ex 2014/NN) Implemented by Luxembourg to Fiat*. *op. cit*., § 36.

435 *Ibid*., § 129 ff.

436 *Ibid*., § 132.

more direct (simpler) method capable of more reliably reflect the functional profile of FFT. The EC, hence, argued for the application of a CUP method, as potentially comparable transactions, even within the group, would be available[437].

Under the applied TNMM, the taxable profits of FFT were benchmarked using the return on its capital at risk[438], as a financial intermediary company. This return comprised the entirety of FFT's profits. Hence, in order to determine its expected return, a capital asset pricing model (**'CAPM'**) was used, which aimed at determining how much FFT should earn for using its own funds, given the specific underlying risks of such a use. The CAPM formula relies on elements such as the determination of the actual capital at risk, of a beta to measure the risk level of the investment comparable to the market and, also, a market risk premium (i.e., a market return minus a risk-free rate)[439]. Translating these elements into the expressions we have been using, they would constitute the cost-base upon which FFT's remuneration (based on the TNMM application) would be calculated.

As within our international/general TNMM analysis above, the EC disputed the determination/composition of the cost-base and the adjustments made by FFT, arguing that FFT should have used all its accounting equity in order to apply a uniform rate of return, instead of segmenting the cost-base and applying different rates to its different, narrower, parts[440]. The EC also disagree with the beta used, as it would translate a lower risk than the one derived from the functional profile (above) of FFT[441].

Differently than in *Starbucks*, the EGC sided with the EC. This represented an interesting turn of events, as the EC's burden of proof[442], in face of similarly overly complex and subjective application of the transfer pricing methods, was assessed differently, having the EGC stated that indeed the disputed APA led to a reduction of the taxable base of FFT in Luxembourg due to results varying beyond the inaccuracies

437 EC, *Commission Decision (EU) 2016/2326 of 21 October 2015 on State Aid SA.38375 (2014/C ex 2014/NN) Implemented by Luxembourg to Fiat. op. cit.*, § 132. As also discussed in: Marc Rasch and Pawel Wroblewski, "European Commission Decision on Fiat: State Aid Case Explained," *International Transfer Pricing Journal* 23, no. 6 (2016), 438.

438 EC, *Commission Decision (EU) 2016/2326 of 21 October 2015 on State Aid SA.38375 (2014/C ex 2014/NN) Implemented by Luxembourg to Fiat. op. cit.*, § 132. Rasch and Wroblewski, *op. cit.*, 439.

439 EC, *Commission Decision (EU) 2016/2326 of 21 October 2015 on State Aid SA.38375 (2014/C ex 2014/NN) Implemented by Luxembourg to Fiat. op. cit.*, § 160. Rasch and Wroblewski, *op. cit.*, 439.

440 EC, *Commission Decision (EU) 2016/2326 of 21 October 2015 on State Aid SA.38375 (2014/C ex 2014/NN) Implemented by Luxembourg to Fiat. op. cit.*, § 237. Also debated in, Ruth Mirembe, "State Aid from the Transfer Pricing Lens: The Fiat Case," *International Transfer Pricing Journal* 32, no. 1 (2025), 28-29 and in Ivan Lazarov and Svitlana Buriak, "Is Fiat's Tank Half-Full or Half Empty? The General Court's Decision in Luxembourg v. Commission (T-755/15)," *International Transfer Pricing Journal* 27, no. 1 (2020),74-76.

441 EC, *Commission Decision (EU) 2016/2326 of 21 October 2015 on State Aid SA.38375 (2014/C ex 2014/NN) Implemented by Luxembourg to Fiat. op. cit.*, § 292 ff.

442 Also recognized herein by the EGC, *vide*: EGC, *Judgment of the General Court (Seventh Chamber, Extended Composition) of 24 September 2019 – Grand Duchy of Luxembourg v. European Commission* (Case T-755/15), *op. cit.*, § 202.

inherent in the methodology used to obtain that approximation (*randomization*)[443].

The CJEU overturned the EGC decision[444] – thus representing a defeat to the EC's efforts. This decision, nevertheless, was based on correct the determination of the reference system, for the verification of the existence of a selective advantage, under the State aid dynamic, rather than on an adequate application of our analysed OECD ALS' *variant* methods and their *approximation* (in face of their *randomization*). Naturally, and as we have mentioned when using the term *defeat* above, the CJEU *Fiat* decision challenged the EC's self-alleged competence in terms of the harmonization of direct taxes in the EU through the *back door*[445].

***Apple***

The *Apple* case was centred in the scrutiny of two APAs involving the Irish tax authority and Apple Sales International (**'ASI'**) and Apple Operations Europe (**'AOE'**), the first concluded in 1991 and the second (rather a renewal of the former) in 2007[446]. ASI was responsible for the sales of Apple products outside of the Americas, purchasing finished goods from manufacturers and selling them to Apple-affiliated companies and third-party resellers[447].

AOE was responsible for the manufacturing of certain Apple products and, in relation to said manufacturing, was engaged in a cost-sharing agreement with Apple Inc., under which AOE was able to share costs and risks of IP development and to retain the IP resulting rights outside of the Americas[448]. Although both ASI and AOE were incorporated in Ireland, none of them were considered as tax residents in Ireland, lacking employees and further physical presence therein[449]. As such, they both operated mainly through branches in that country[450].

Although most of the discussions on the *Apple* case revolve around both the choice of reference system (as with *Starbucks* and *Fiat*) and the applicability of the AOA to the

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443 EGC, *Judgment of the General Court (Seventh Chamber, Extended Composition) of 24 September 2019 – Grand Duchy of Luxembourg v. European Commission* (Case T-755/15), *op. cit.*, § 188 ff.

444 Court of Justice of the European Union (CJEU), Judgment of the Court (Grand Chamber) of 8 November 2022 – *Fiat Chrysler Finance Europe and Ireland v. European Commission* (Joined Cases C-885/19 P and C-898/19 P), ECLI:EU:C:2022:859.

445 This discussion can be seen in different articles around the *Fiat* case, e.g.: Min Shi, "Fiat Emerges Victorious in State Aid Battle with European Union: What's Next?" *European Taxation* 63, no. 2/3 (2023), 129; Rasch and Wroblewski, "Fiat State Aid Coming to a Positive End?" *International Transfer Pricing Journal* 29, no. 3 (2022), 217.

446 EC, *Commission Decision (EU) 2017/1283 of 30 August 2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) Implemented by Ireland to Apple. op. cit.*, § 4.

447 *Ibid.*, § 54.

448 *Ibid.*, § 116 ff.

449 EC, *Commission Decision (EU) 2017/1283 of 30 August 2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) Implemented by Ireland to Apple. op. cit.*, § 48 ff.

450 *Ibid.*, § 47.

attribution of profits to the Irish branches[451], we will focus, again, on the points raised regarding the (mis)application of the transfer pricing methods.

In simple terms, both ASI and AOE used a TNMM-alike method, based on the then applicable Irish legislation, in order to calculate a routine profitability for their respective branches in Ireland, leaving high profits at the level of the head-offices[452]. The EC found, within its subsidiary line of reasoning, that the choice of the Irish branches as tested parties to the application of the method was inappropriate based on their functional profiles[453]. Additionally, the EC also raised its disagreement with the choice of the profit level indicator (and the cost base upon which the indicator was applied)[454] and with the level of returns to the Irish branches validated in the APAs (results of the comparability analysis)[455].

As in *Starbucks*, and differently than in *Fiat,* the EGC set aside the EC decision. Although the EGC stated that, especially in regard to the discussed second line of reasoning of the EC, the identified defects in the method applied demonstrated "the incomplete and occasionally inconsistent [*with the arm's length standard*] nature of the contested tax rulings"[456], it went on to conclude that "these are not sufficient to prove existence of an advantage for the purpose of Art. 107 (1) TFEU"[457].

The CJEU reverted the EGC's decision[458] based on the first line of reasoning/ground of appeal of the EC, largely following the opinion of the Advocate General

451 *Ibid.*, § 228 and 324 *See*, e.g.: Isabel Verlinden and Stefaan De Baets, "The ECJ Apple Judgment: A Sour Tarte Tatin," *International Transfer Pricing Journal* 32, no. 1 (2025), 6-8 and Charles Garavan, "The Apple Case: The Right Decision for the Wrong Reasons?" *European Taxation* 64, no. 12 (2024), 549-542.

452 EC, *Commission Decision (EU) 2017/1283 of 30 August 2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) Implemented by Ireland to Apple op. cit.*, § 328-333. As also described by the Confédération Fiscale Européenne in its opinion statement to the EGC's decision: Confédération Fiscale Européenne (CFE) ECJ Task Force, "Opinion Statement ECJ-TF 3/2020 on the General Court Decisions of 15 July 2020 in *Ireland v. Commission* and *Apple v. Commission* (Joined Cases T-778/16 and T-892/16) on State Aid Granted under Tax Rulings Fixing the Attribution of Profits to Permanent Establishments in Ireland," *European Taxation* 61, no. 2/3 (2021), 110.

453 EC, *Commission Decision (EU) 2017/1283 of 30 August 2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) Implemented by Ireland to Apple*. *op. cit.*, §328 ff.

454 EC, *Commission Decision (EU) 2017/1283 of 30 August 2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) Implemented by Ireland to Apple*. *op. cit.*, § 334 ff.

455 *Ibid.*, § 346-359.

456 European General Court (EGC), *Judgment of the General Court (Seventh Chamber, Extended Composition)*, *Ireland v. European Commission* and *Apple Sales International and Apple Operations Europe v. European Commission*, Joined Cases T778/16 and T892/16, ECLI:EU:T:2020:338, 15 July 2020, § 479.

457 EGC, *Judgment of the General Court (Seventh Chamber, Extended Composition)*, *Ireland v. European Commission* and *Apple Sales International and Apple Operations Europe v. European Commission*, *op. cit.*, § 479.

458 CJEU, Judgment of the Court (Grand Chamber) of 10 September 2024 – Case C-465/20: *European Commission v. Ireland and Others*. *op. cit.*, § 253-259.

Pitruzzella[459], and, hence, did not further scrutinized the points we have raised in regard to a potential misapplication of the transfer pricing method.

***Amazon***

Finally, in *Amazon*, the EC's decision focused on an APA concluded in 2003 and renewed in 2010, between the Luxembourgish tax authority and Amazon's Group companies, i.e., Amazon EU Sàrl ('LuxOpCo') and Amazon Europe Holding Technologies SCS ('LuxSCS')[460]. LuxOpCo was the operator of Amazon's European retail and e-commerce business, managing European websites, handling sales and overseeing logistic operations[461]. LuxSCS held Amazon IP rights for Europe and had the determined role of managing said IP, although it had no employees[462].

The analysed APAs within the scope of the EC's decision related to royalty payments made by LuxOpCo to LuxSCS for the right to use the Amazon IP in its European operations[463], as described above. The arm's length nature of the royalty payments was verified based on the application of an (internal) CUP method[464], under which adjustments were made to cope up with the differences in the scopes of the contracts/agreements. A corroborative analysis was also made[465], to verify the arm's length nature of the royalty payments, based on the application of a (residual) profit split method[466], under which, after the calculation of the routine return associated with LuxOpCo, all the residual profit was allocated to LuxSCS, as a remuneration for LSCS.

The EC contested the application of both the described methods. Initially, the EC argued for the lack of clearly identifiable adjustments to the internal CUP assessment and that this impaired the comparability exercise, due to a supposed holistic approach used in the comparison of contracts involving different services[467]. The EC then stated that the (mis)application of the CUP led to an exaggerated payment[468], hence reducing the taxable profits of LuxOpCo in Luxembourg.

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459 Giovanni Pitruzzella. Opinion of Advocate General in *European Commission v. Ireland, Apple Sales International, Apple Operations International (formerly Apple Operations Europe), Grand Duchy of Luxembourg, Republic of Poland, and EFTA Surveillance Authority*, Case C-465/20 P, ECLI:EU:C:2023:869, delivered on 9 November 2023.

460 EC, *Commission Decision (EU) 2018/859 of 4 October 2017 on State Aid SA.38944 (2014/C) (ex 2014/NN) Implemented by Luxembourg to Amazon*. *op. cit.*, § 121-122.

461 *Ibid.*, § 108.

462 *Ibid.*, § 104.

463 EC, *Commission Decision (EU) 2018/859 of 4 October 2017 on State Aid SA.38944 (2014/C) (ex 2014/NN) Implemented by Luxembourg to Amazon*. *op. cit.*, § 154.

464 *Ibid.*, § 140-141.

465 *Ibid.*, § 152.

466 EC, *Commission Decision (EU) 2018/859 of 4 October 2017 on State Aid SA.38944 (2014/C) (ex 2014/NN) Implemented by Luxembourg to Amazon*, *op. cit.*, § 146.

467 EC, *Commission Decision (EU) 2018/859 of 4 October 2017 on State Aid SA.38944 (2014/C) (ex 2014/NN) Implemented by Luxembourg to Amazon*, *op. cit.*, § 530.

468 *Ibid.*, § 532.

The EC also contested the application of the (residual) PSM, based on the argument that all *residual* profit calculated was attributed/allocated to LuxSCS, The EC then argued that such allocation was contrary to/invalidated the premises of the PSM, under which *both* parties to the transaction perform valuable and unique contributions[469]. The EC went on to argue that a TNMM would be applicable to the case instead[470].

Initially, the EC upheld Amazon's and Luxembourg's plea against the TNMM proposed by the EC, including the fact that LuxSCS should be used as the tested party[471]. Accordingly, the EGC stated that the EC's proposed method, was "vitiated by numerous errors and cannot be regarded as sufficiently reliable or capable of achieving an arm's length outcome"[472]. The ECG also upheld the disputed APA's PSM application[473], thus siding with Amazon and Luxembourg and reverting the EC decision.

The CJEU rejected the EC's appeal and upheld the EGC decision[474].

All the cases discussed herein highlighted the *approximate* nature of the arm's length standard. A deviation from the ALS is only deemed to occur, as repeatedly raised in the discussed cases, once the inaccuracies found within the underlying transfer pricing methodology applied go beyond those which are *inherent* to that specific methodology. We have referred to this inherent approximation as *tolerable*, *reliable*, which we have then opposed to our view of *randomization*. In short, for us (but also for the EU institutions and international courts, as demonstrated), the first is an acceptable and even desirable feature of the ALS, adding the necessary flexibility to the arm's length *praxis*. The second, on the other hand, is a product of the misapplication of the transfer pricing methods (or, likewise, of some non-arm's length methods[475]) when leading to results which fail to foresee the mimicking of the results which would have been obtained by unrelated parties have them be in comparable circumstances (minding, naturally, our already discussed *unabridged levelling* notion[476]).

As we have discussed, the line separating the *approximation* and the *randomization* has been subject to an intensive blurring, potentialized by the weaknesses and issues of

469 EC, *Commission Decision (EU) 2018/859 of 4 October 2017 on State Aid SA.38944 (2014/C) (ex 2014/NN) Implemented by Luxembourg to Amazon*, *op. cit.*, § 541.

470 *Ibid.*, § 541-542; 553 ff.

471 European General Court (EGC). *Judgment of the General Court (Seventh Chamber, Extended Composition) of 12 May 2021 – Grand Duchy of Luxembourg v. European Commission (Case T-816/17); Amazon EU Sàrl and Amazon.com, Inc. v. European Commission (Case T-318/18)*, ECLI:EU:T:2021:252, § 296.

472 *Ibid.*, § 296.

473 *Ibid.*, § 531 ff.

474 Court of Justice of the European Union (CJEU). *Judgment of the Court (Second Chamber) of 14 December 2023 – European Commission v. Grand Duchy of Luxembourg, Amazon.com, Inc. and Amazon EU Sàrl (Case C-457/21 P)*, ECLI:EU:C:2023:1004.

475 Although, as we will shortly turn to, some non-arm's length methods *might* also not produce random results, as it is the case within our super hard formula-based considerations, *vide* Section 3.2.5.1 below.

476 Following the wording of Aitor Navarro *in*: Navarro, *op. cit.*, 361.

the transfer pricing methods, streaming from their growing complexity and subjectivity. This blurring has contributed, in all cases (although, still, some were decided on different grounds), to questions on the correct application of the arm's length standard, herein viewed as a potential lead to the *selective advantages* in this EU (fiscal) State aid context.

The *randomness*, nevertheless, was not considered as the sole factor leading to the conclusion on the existence of a selective advantage, as (mis)applications of the transfer pricing methodology (i.e., a methodological error) might not necessarily give rise to an advantage[477]. The main challenge here (which was mostly faced by the EC) is the actual *burden of proof* to demonstrate the existence of an advantage within the *randomness*. The *lack of the objective and verifiable* criteria, which we have focused on within our assessment of the EU fundamental freedoms' case, also adds to the *mix,* although we see a certain disconnection in the CJEU's assessments, as this lack was not directly assessed in the cases we are now debating.

Anyhow, the result is an increase in cases of transfer pricing disputes, potentially leading to double taxation (e.g., aggressive 'cherry picking from the EC) or double non-taxation (e.g., advantageous APAs) and to the unsustainability of current ALS *variant*, now highlighted within an EU context.

Within these conclusions, a few additional notes must be shared.

The first is regarding the limits to what the inherent inaccuracies to the methodology *actually* are, something not profoundly discussed in any of the cases analysed within this Section. For us (and perhaps amending our above-comments), current weaknesses and issues of the transfer pricing methods have led their inherent inaccuracies to go beyond the tolerable, reliable approximation, meaning that, even their inherent inaccuracies significantly impar their capabilities to produce "a range of figures all of which are relatively equally reliable"[478]. The consequence of that been, for a myriad of different transfer pricing methods (also in line with the general/international assessment part of this Section) the *randomization* process is even more rooted within the arm's length *praxis*.

On a second note, interestingly, the *burden of proof* element, which we have highlighted not only within this EU assessment, but generally, plays a pivotal role in the transfer pricing disputes[479]. As such, how the *burden of proof*, often found within a scenario of *information asymmetry*[480] and accompanied by a significant administrative

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477 EGC, *Judgment of the General Court (Seventh Chamber, Extended Composition) of 12 May 2021 – Grand Duchy of Luxembourg v. European Commission (Case T-816/17); Amazon EU Sàrl and Amazon.com, Inc. v. European Commission (Case T-318/18)*, *op. cit*., e.g., § 532 and 587

478 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*, *op. cit*., § 3.55.

479 As in, e.g., EGC, *Judgment of the General Court (Seventh Chamber, Extended Composition)*, *Ireland v. European Commission* and *Apple Sales International and Apple Operations Europe v. European Commission*, Joined Cases T778/16 and T892/16, *op. cit*., § 319.

480 Also discussed in Fleming Jr., Peroni and Shay, *op. cit*., 171.

burden, is allocated between the parties to the specific transfer pricing dispute becomes crucial. Consequently, failure to overcome the constrains of this element might shadow the application of the transfer pricing methods in a way inconsistent with the arm's length *core*, practically leading to an authorization of *random* results.

This has a parallel with the typical setting of domestic legislations, under which the tax authorities bear the initial burden to demonstrate that a taxpayer's transfer prices deviate from the arm's length standard, while such burden is only shifted to the taxpayer in case of formal/substantial breach of transfer pricing documentation/ substantiation requirements.

In a nutshell, it can be concluded that the increasing complexity and subjectivity of the transfer pricing methods might lead to an advantage for taxpayers (and for a few jurisdictions, in the EU (fiscal) State aid context) over tax authorities, as the limits between a reliable approximation and a *randomization* of the results are, as stated, fairly blurred. It is often a *diabolic* burden for tables to be turned.

The lack of more *objective* and *verifiable* criteria, although not directly discussed in the EU (fiscal) State aid cases are deemed to contribute to the problem. The *unpredictability* (i.e., lack of legal certainty, changing of assessments in case law), related to the increasing subjectivity (*judgement calls*) and the consequent widening of the results range (beyond the refection of an approximate arm's length result, in the terms we have been discussing) thus culminate in a *randomization* of the arm's length results that, within the EU, beyond the general/international assessed issues, render the ALS variant(s) in the region simply incompatible with the State aid rules, so keen to the EU.

These points are potentially solvable (*partially*) with the adoption of certain reimagination measures, as we will further discuss under Section 3.2.5 and Chapter 4 below, with the idea of the *formula-based alternatives*. Their introduction in the arm's length *praxis* could better level the strengths in this relationship (i.e., taxpayers/tax authorities, or better yet, defendants and contestants), potentially leading to a more sustainable and less disputable transfer pricing.

Finally, the issue of the determination of the *reference system*, present in all the discussed cases, although set aside for the scope of our considerations within this Section, can be tackled via the adoption of increased coordination (*harmonization?*) measures in the EU. This is to say that a potential increased cooperation (now, from an EU perspective) could have led e.g., *Apple* towards a different direction.

### *3.2.5. The Formula-Based Alternatives*

The formula-based alternatives (**"FBA"**), within which we will also include solutions referred to in the literature as *formulary apportionments* or *formulaic approaches*, present potential solutions to the identified transfer pricing methods' insufficiencies, analysed within this Chapter 3, and are *allegedly* capable of addressing the *randomization* of the arm's length result, trough the introduction of more of the missing *objective* and *verifiable* criteria of current ALS, thus also alleviating the information asymmetry existing in its application[481]. In addition, this shall, in an EU context, allow for a smoother passing of the justification test within the fundamental freedoms case line, as well as limit the possibility of EU Member States to hinder selective advantages conferred in the context of forbidden (*fiscal*) State aid, as extensively addressed in this Chapter.

Formula-based alternatives could also be applied in a broader/more comprehensive way than, e.g., the rather individual, targeted measures, embodied in APAs and, as such, serve as part of a more systematic solution to the contemporary challenges of the ALS. For us, for the purposes of this research, we understand formula-based alternatives to include any pre-determined/established element, not necessarily meaning a *mathematical* formula. These include the establishment of *ex-ante* elements to the arm's length (and transfer pricing methods) operation.

As introduced above, formula-based alternatives (or *solutions*) are not a novelty in international tax law - they date back to the very first discussions on the matter and were significantly addressed by Mitchell B. Carroll already in his 1933 Report to the League of Nations[482].

Since then, formula-based solutions have been propagated in various different forms and shapes, which, in our view, span a *continuum* from stricter versions, where MNEs are treated as a consolidated unit (i.e., enterprise approach) under a *super hard* formula-based solution, to softer, more tailored applications, that seek to approximate independent market behaviours (and results) within an entity framework. This *continuum* allows for categorizing formula-based solutions into *super hard*, *hard* and *light* versions, each defined (and differentiated) by two distinctive elements: (i) their reliance on either an enterprise or an entity approach and (ii) their orientated goal towards mimicking an *approximate* arm's length-like result, within our delineated understanding of the term.

The *super hard* formula-based approaches are necessarily grounded on a *hard enterprise* view, where MNEs are treated as a single economic unit and profits are allocated solely having in mind the need to distribute taxing rights among jurisdictions. Conversely, a *hard* formula-based approach already incorporates aspects of an *entity* view, where individual entities' contributions are recognized and simplified approaches are used to allocate the profits, while *not* based on the outcome expected by independent parties. Finally, the *light* formula-based solutions *also* incorporate aspects of an *entity* approach, but the adopted formulas do aim to *mimic* an ALS-like outcome or result.

While all FBA points (or, rather, *ranges*) within the *continuum* should in theory

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481 In that regard, Fleming Jr., Peroni and Shay state that "the [OECD variant of the] arm's length approach creates system-gaming scenarios in which the greater information and professional resources available to MNEs allow them to overwhelm tax administrations.", *see* Fleming Jr., Peroni and Shay, *op. cit.*, 171. *See also*: Avi-Yonah and Benshalom, *op. cit.*

482 For a historic overview of the formula-based alternatives, *vide*: Richard Krever and Peter Mellor. History and Theory of Formulary Apportionment *in The Allocation of Multinational Business Income: Reassessing the Formulary Apportionment Option*. Ed. Richard Krever and François Vaillancourt. Series on International Taxation, v.76. Wolters Kluwer. 2020: 9-39.

be capable of addressing the issue of the lack of verifiable and objective criteria, not all these points would be, in our view, suitable to feasibly (and efficiently) tackle the *randomization* problem, i.e., because not all possible FBA would fit within our established arm's length *core* and, hence, could fall outside our drawn *feasibility framework* of implementation.

Categorizing the different types of formula-based solutions within *super hard*, *hard* or *light* categories, and understanding examples of their applications, will allow us, then, to determine what is the limit that formula-based solutions can be suggested as part of our answer to this research question, as already anticipated above.

The figure below illustrates our FBA *continuum*.

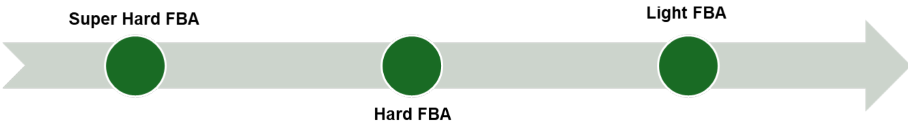


**Figure 3. The formula-based alternatives continuum**

*General* open items (or remaining key issues) with the possible adoption of an FBA will be addressed under Section 3.2.5.4 below.

### *3.2.5.1. The Super Hard Formula-Based Alternatives*

Initially, *super hard* formula-based alternatives are positioned on the firmer end of the *continuum*.

They apply formulas that substantially diverge from the arm's length *rationale* by apportioning income neither aiming to reflect the parties *individual* and *actual* ability-to-pay, nor the behaviour of independent parties (market price[483]).

Within this firmer end of the *continuum*, the *super hard* formula-based approaches are akin to *unitary* taxation, within which the entire MNE is treated under our *hard enterprise* view, with the subsequent need to consolidate all global income (treated as of a single economic unit) and apportion it across jurisdictions[484] (or across different subnational divisions, for systems under which this is applicable).

Examples of the application of *super hard* formula-based alternatives (on a subnational level) stream from the United States practice[485]. Contemporarily, OECD Pillar I Amount A proposal is another example of a *super* hard formula-based approach

483 To use the terminology adopted by Avi-Yonah and Benshalom in: Avi-Yonah and Benshalom, *op. cit.*, 17.

484 For a deeper discussion on the enterprise view/approach, please refer to Section 3.1.4 of this study.

485 As detailed by: Shirley Sicilian and Joe Huddleston. "The US States' Experience with Formulary Apportionment" *in The Allocation of Multinational Business Income: Reassessing the Formulary Apportionment Option*. Ed. Richard Krever and François Vaillancourt. Series on International Taxation, v.76. Wolters Kluwer. 2020: 41-74.

discussed in this study, introducing a new taxing right for market jurisdictions over a predetermined share of the residual profits of MNE's, accounted for on a consolidated basis[486].

As such, Amount A does not involve a comparability analysis (not even in its *broader* sense) making no reference to comparable uncontrolled prices, market benchmarks, or transactional-level evaluations, for example. Instead, Amount A would operate through the application of consensus-based formulas designed to reflect an arguably desired portion of global profit attributable to market engagement[487].

Similarly, several proposed and adopted DST are also based on a *hard* enterprise approach, as within OECD Pillar I, Amount A.

Hence, the *super hard* FBA aim with the profit allocation exercise is *neither* to determine the precise source of the income *nor* to get a more precise view of the individual ability-to-pay of the entities/units[488]. Additionally, it completely disregards *all conditions* established between the parties and merely (re)allocate taxing rights and taxing revenues among countries in the international community. Although we have established that this redistributive goal can also be seen as one of the *roles* of the arm's length standard, it can never be *unaccompanied* by the observance of the ability-to-pay principle and, thus, the *super hard* FBA seems contrary to the established ALS core.

Authors like Avi-Yonah and Benshalom would even likely consider our *super hard* FBA to be *outside* of the formulary *continuum*. For these authors, while our *super hard* FBA represents an expression of a unitary regime, it *substantially* differs from (our *hard* and *light*) FBA because the latter does not require the additional consolidation efforts[489], present under a *super hard* enterprise approach. Consequently, only the *hard* and the *light* FBA maintain the relevance of the determination of the source (State) of the income, *potentially* aligning them to current international tax dynamics.

From an EU Law perspective, a *super hard* FBA would likely represent an insurmountable restriction to the discussed freedom of establishment, at least if the long-lasting premise that associated and non-associated parties are under comparable circumstances - as both would be *equally* subject to the objective of the Member States CIT rules - would be valid[490]. This insurmountable restriction is true as the *super hard*

486 As in: OECD, *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy*, *op. cit*.

487 *Ibid*.

488 These are two different elements. It is possible that the allocation exercise tries to identify the source of the actual income but do so with regards not to the ability-to-pay principle, but to other principles/grounds, as with the *exchange* or *benefits* theory. This distinction was found and explored since the Four Economists Report: League of Nations. *Report on Double Taxation Submitted to the Financial Committee*, *op. cit*.

489 Avi-Yonah and Benshalom, *op. cit*., 17-18.

490 Contrary opinions do exist as expressed, e.g., by the then Advocate General Michal Bobek, in his opinion to the *Hornbach-Baumarkt* case: Michal Bobek, Opinion in *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit*., § 69.

FBA would inevitably provide for a disadvantageous treatment of the MNE[491] - as this disadvantageous treatment needs only to be potential, thus leaving little to no room of compatibility for the *super hard* FBA in current understanding/application of the EU fundamental freedoms to (corporate) profit allocation exercises.

Hence, and in confluence with both the cited Avi-Yonah and Benshalom ideas[492], but also with Schoueri[493], we see *super hard* FBA approaches to be *incompatible* with the ALS and we will not further consider alternatives within this category.

### *3.2.5.2. The Hard Formula-Based Alternatives*

Conversely, the *hard* FBA adopts an *entity* approach that respects individual contributions from different entities within the group, with the use of formulas to determine income allocation, nevertheless, without basing such allocation formulas on an arm's length logic - allowing for *non-principled-based* formulas, as we will further call them.

The evolution of the transfer pricing rules in Brazil – from where this author comes – represents an interesting didactic illustration of both this *hard* and, ahead, *light* formula-based alternatives' categories. Enacted in 1996, Law No. 9.430/1996, in its Art. 18-24[494] (**"Brazilian Transfer Pricing Rules"**), established transfer pricing rules in Brazil, *not* following the footsteps of the international movement after the publication of the 1995 OECD Transfer Pricing Guidelines[495]. The Brazilian Transfer Pricing Rules did *not* expressly adopt the arm's length standard (or even a presumably equivalent expression) but has also not rejected it. Some of its provisions through its time evolution assessment, although based on an *entity* view, applied formulas which did not seem to care about mimicking an arm's length-like result and, as such, would likely fall within our *hard* category.

As an example, the original wording of Art. 22 of the Brazilian Transfer Pricing Rules, when prescribing the methods to be applied to the calculation of intra-group interest payments, stated that:

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491 This derives from the opinion of the Court in cases such as *Hornbach-Baumarkt*: ""Freedom of establishment is hindered if, under a Member State's system, a resident company having a subsidiary in another Member State suffers a disadvantageous difference in treatment for tax purposes compared with a resident company having a subsidiary in the first Member State." CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit*., § 32.

492 Avi-Yonah and Benshalom, *op. cit*., 17-18.

493 Schoueri. *op. cit*., 690-716.

494 Lei No. 9.430, of 27 December 1996, Provides for federal tax legislation, social security contributions, the administrative consultation procedure, and other provisions, *Diário Oficial da União*, 30 December 1996. Brazil has aligned its transfer pricing legislation with the current OECD variant from the publication of the provisory measure (*Medida Provisória*) n. 1.152/2022, further converted into law (Lei n. 14.596/2023).

495 Organisation for Economic Co-operation and Development (OECD) and Receita Federal do Brasil, *Transfer Pricing in Brazil: Towards Convergence with the OECD Standard*. Paris: OECD Publications, 2019, § 20.

> "Interest paid or credited to a related party, when arising from a contract not registered with the Central Bank of Brazil, will only be deductible for the purposes of determining real profit up to the amount that does not exceed the value calculated based on the Libor rate, for deposits in United States dollars for a term of six months, plus three percent per year as a spread, proportional to the period to which the interest refers."[496] (*Our translation*)

In December 2012, nevertheless, Art. 22 of the Brazilian Transfer Pricing Rules was amended and read as below:

> "Interest paid or credited to a related person will only be deductible for the purposes of determining real profit up to the amount that does not exceed the value calculated based on the rate determined in accordance with this article plus a percentage margin as a spread, to be defined by an act of the Minister of Finance based on the market average, proportional to the period to which the interest refers."[497] (*Our translation*)

Whether the amended wording of Art. 22 above already included elements which could be seen as an intent to *approximate* the results to those which would have been obtained by related parties in comparable circumstances is debatable, it highlights the practical difficulties (and *blurred lines*) in defining the limits to the *hard* formula-based solutions and the *light*-formula based solutions.

South Korea seems to have also adopted a similar alternative to the pricing of financial instruments, as seen in the Brazilian Transfer Pricing Rules[498], while Mexico introduced an industry specific *hard* FBA mechanism, which consists in determining the tax profit base as the maximum value that results from applying a predetermine percentual on the total value of the assets or on the total amount of costs and expenses[499]. As far as we understand, and still minding the possible blurring of lines between the *hard* and the *light* FBA, neither the Korean nor the Mexican examples above aim at mimicking an ALS-alike outcome, although both these jurisdictions *generally* follow an ALS system[500].

Determining whether a *hard* FBA would fit within our established arm's length core is a less straightforward exercise, as its application may *eventually* lead to an arm's

496 Brazil, *Lei nº 9.430, 27 December 1996*, *Diário Oficial da União*, 30 December 1996, Art. 22.

497 Brazil, *Lei nº 9.430/1996*, *27 December 1996*, Art. 22, as amended by *Lei nº 12.766/2012*, *Diário Oficial da União*, *Diário Oficial da União*, 28 December 2012.

498 *Vide*: Organisation for Economic Co-operation and Development (OECD), *Transfer Pricing Country Profile: Korea*, February 2022, 1, https://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profile-korea.pdf (accessed 14 April 2025).

499 *Vide*: Organisation for Economic Co-operation and Development (OECD), *Transfer Pricing Country Profile: Mexico*, December 2021, 1, https://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profile-mexico.pdf (accessed 14 April 2025).

500 Also based on the OECD Transfer Pricing Country Profiles used above. OECD, *Transfer Pricing Country Profile: Korea*, February 2022, *op. cit.*, 1; OECD, *Transfer Pricing Country Profile: Mexico*, December 2021, *op. cit.*, 1.

length result. Differently from authors as Avi-Yonah and Benshalom[501], we still believe that *hard* FBA cannot be deemed in line with the ALS as, based on our established ALS core, although *results* are an essential part of it, the arm's length must always be *principle-based*. The lack of direct intent to mimic independent part behaviours, therefore, would necessarily deem a *hard* FBA incompatible with the ALS, even though there is a "check in the box" on the importance of the income's source determination.

#### *3.2.5.3. The Light Formula-Based Alternatives*

Finally, on the opposite end of the FBA *continuum*, *light* FBA approaches retain essential elements common to the ALS established *core*, by tailoring formulas not only to consider the individual entities results' within an MNE (and the respective *source* of the income), as within the *hard* variants above described, but also to *mimic* how independent parties would interact, accounting for an ability-to-pay analysis, to achieve an ALS-like result (principle-based FBA).

An at least *broad comparability* exercise/analysis, therefore, is needed within a *light* FBA, while dispensed in a *hard* one.

This is reflected in the wording of Art. 18, II, d, and § 12 of the Brazilian Transfer Pricing Rules, as amended in September 2012, *in verbis*:

> "Art.18. Costs, expenses and charges related to goods, services and rights, as set out in import or acquisition documents, in transactions carried out with a related person, shall only be deductible in determining real profit up to the amount that does not exceed the determined price, in compliance with the conditions set forth in this provision, by one of the following methods:
>
> II - Resale Price Less Profit Method - PRL: defined as the weighted arithmetic average of the sales prices, in the Country, of imported goods, rights or services, **under similar payment conditions** and calculated according to the following methodology:
>
> (...)
>
> d) profit margin: the application of the percentages provided for in § 12, according to the economic sector of the legal entity subject to transfer pricing control, on the share of the imported good, right or service in the sales price of the good, right or service sold, calculated in accordance with item c.
>
> § 12. The margins referred to in item d of subsection II of the caput will be applied according to the sector of economic activity of the Brazilian legal entity subject to transfer pricing controls and will apply, regardless of whether or not it is subject to a production process in Brazil, to the following percentages (...)"[502] (Our translation and highlights).

501 Avi-Yonah and Benshalom, *op. cit.*, 17-18.

502 Brazil, *Lei nº 9.430/1996*, *27 December 1996*, Art. 18, as amended by *Lei nº 12.715/2012*, *Diário Oficial da União*, *Diário Oficial da União*, 17 September 2012.

Although, in principle similar to our Mexican example above, evidencing the *blurred lines* between the *hard* and *light* FBA, the Brazilian method under Art. 18 shows a certain concern with *comparability*. This is reflected in the observance of *actual* average comparable prices (i.e., "under similar payment conditions") in the determination of the transfer prices, in combination with an industry/economic sector segregation of the formulaic elements (*ex-ante* determined percentage of profits), which might reflect additional concern with an approximated mimicking of independent parties' behaviour's led results.

Similarities to a comparability assessment found under the ALS *praxis* in provisions such as the collated above led to the discussions on whether the ALS was implicitly a part of the Brazilian Transfer Pricing Rules[503]. In recent discussions between the Brazilian Federal Tax Revenue (*Receita Federal*) and the OECD, these similarities were not perceived as sufficient to establish Brazilian's then applicable legislation as in line with the ALS[504]. If adjusted to our terminology (and underlying understanding), nevertheless, the conclusion of said analysis would have rather been that the Brazilian Transfer Pricing Rules were rather incompatible with the OECD's ALS *variant*, but not with the ALS in itself. Contrariwise, Brazilian Transfer Pricing Rules' *light* formula-based alternative elements can significantly contribute to our *reimagination* process.

Interestingly, the *light* formula-based alternatives are also found within the realm of the current OECD ALS *variant* in itself. The Low Value Adding Services (**"LVAS"**) approach, prescribed by the OECD Transfer Pricing Guidelines since its 2017 version[505] is an example. The LVAS applies as an elective simplification mechanism, under which certain low-value/ routine services (i.e., administrative, IT support, accounting, and similar back-office services), can be priced using a standardized 5% mark-up on the relevant cost base (also following objective instructions set out by the Guidelines), without requiring a detailed benchmarking analysis[506], although intending to approximate results which are expected in the market to such a nature of services[507].

As set out by the OECD Transfer Pricing Guidelines, this approach is intended to reduce compliance burdens and disputes by providing a clear and administratively efficient method for dealing with services that do not involve significant risks, do not

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503 Ricardo Marozzi Gregorio. *Preços de Transferência: Arm's Length e Practicabilidade*. Série Doutrina Tributária V.5. IBDT, Quartier Latin. 2011: 262-265.

504 *Vide*, e.g.: OECD and Receita Federal do Brasil, *Transfer Pricing in Brazil: Towards Convergence with the OECD Standard. op. cit.*, § 12-25.

505 Organisation for Economic Co-operation and Development (OECD). *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*. Paris: OECD Publications, 2017, § 7.52 and following.

506 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*, § 7.43 ff.

507 This is corroborated by the OECD in, e.g.: "(…) the simplified approach recognises that the arm's length price for low value-adding intragroup services is closely related to costs, allocates the costs of providing each category of such services to those group companies which benefit from using those services, and then applies the same mark-up to all categories of services. (…)" in *Ibid.*, § 7.43.

contribute to the group's core business, and do not rely on the use of unique and valuable intangibles. To apply the simplified approach, the taxpayer must still demonstrate that the services were actually rendered and provided a benefit to the recipient, but the method eliminates the need for extensive functional analysis or local comparable, provided the services meet the defined eligibility criteria[508]. This is very much in line with our idea of the benefits of an even broader adoption of light formula-based alternatives, as we will further discuss.

Once again resorting to the proposed OECD work on Pillar I, its Amount B can be said to represent a *light* formula-based alternative example[509]. As described under our *time* evolution assessment within this research, Amount B sets out a fixed return mechanism for entities performing defined baseline marketing and distribution functions in market jurisdictions. The return is determined using a streamlined approach, based on a pricing matrix derived from comparability analyses[510]. The aimed returns are explicitly intended to be consistent with the ALS[511], reflecting outcomes that would typically arise in comparable uncontrolled transactions, hence fulfilling the requirements for our light formula-based alternatives' classification.

As we have discussed under our *time* evolution assessment, the actual implementation of Pillar I, Amount B in an international context is still questionable.

What we have broadly called/categorized as *light* FBA approaches seem to be endorsed by many (beyond the OECD in itself, although not *explicitly*, if one will). Avi-Yonah and Benshalom postulate that, under certain circumstances, such alternatives can offer an effective compromise between precision and administrative simplicity[512]. Gustavo Resende further highlights the importance of these as simplification safeguards within the arm's length and transfer pricing practice[513]. We will turn to the possible role of FBA as a simplification safeguard tool below, although the exemplified LVAS approach also showcases this importance.

Despite many authors, as we will see below, not endorsing the idea that (*light*) FBA can be deemed compatible with the ALS and used as a part of it, we believe that *light* FBA represents a practical solution that remains compatible with both ability-to-pay and comparability analysis notions of our established arm's length *core*.

Nothing in our ALS *time* evolution assessment and within the consequently established arm's length *core* seems to be against the idea that arm's length results (even

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508 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*, § 7.43 ff.

509 And, perhaps, the MI proposal, before it, as discussed by Vikram Chand, in: Chand, ""Allocation of Taxing Rights in the Digitalized Economy: Assessment of Potential Policy Solutions and Recommendation for a Simplified Residual Profit Split Method", *op. cit.*, 1033.

510 OECD, *Pillar One – Amount B. op. cit.*, § 44.

511 As reflected in, e.g.: *Ibid.*, § 45.

512 Avi-Yonah and Benshalom, "*op. cit.* We will further use some elements of what the authors then call a *hybrid solution* in our proposal - we agree with this idea, although we disagree with the way the mentioned authors have structured it.

513 Weiss de Resende. *op. cit.*, 336–344.

within an idea of *approximation*[514]) cannot be obtained through the application of formulas (under our definition of the term). Additionally, and minding practicability, as demonstrated with our *space* variants examples, we see that light FBA can be perfectly integrated within current transfer pricing methods *praxis*, thus contributing to more objective and verifiable criteria and, ultimately, to addressing the *randomization* issue.

Practical challenges to this potential compatibility will, nevertheless, be discussed (beyond the mere theory) under our Section 4.1.2 below, introducing our *specific* light FBA proposal.

### *3.2.5.4. Key Issues with the Formula-Based Alternatives*

Again, FBA is not a novelty in our field of study. As such, time did not fall short and several analysis/criticisms to it were made, some broader (directed towards all of our *continuum*), some narrower. Naturally, within this Section, we will turn to the main of these criticisms, especially scrutinizing some of those which relate to the FBA potential compatibility with the ALS.

Initially, the FBA can be said to be *arbitrary*[515]. Among those siding with this understanding, Schoueri states that FBA are "methodologically wrong"[516], on the grounds that, even though *we* consider the *light* FBA to be principle-based, it would ignore a comparability analysis and establish *arbitrary* results to the profit allocation exercise. Still according to Schoueri, these would, henceforth, not even be 'subjectable' to an ability-to-pay compliance assessment, thus unable to reflect independent parties/market behaviour[517]. Well, while this holds true for both a *super hard* and a *hard* FBA, the same cannot be sustained in the face of a *light* FBA.

First of all, Schoueri seems to centre the arm's length assessment on a rather 'restricted' (or traditional) notion/understanding of the term 'comparability'. As we have previously concluded, within our ALS *core* analysis (Section 2.2.2), the core of the ALS should (and, in fact, *is*) able to accommodate a much broader understanding of the comparability requirement. Pillar I Amount B is an excellent example of that[518] (inexistent, though, at the time of Schoueri's cited considerations) - relying on an even more farfetched comparability assessment than the 'standard' TNMM and the PSM (which, in their turns, are already a stretch from the traditional view of the arm's length comparability).

There are several reasons for our understanding being as it is.

Firstly, because the understanding of the term comparability, as put forward by Schoueri, only emerged (or, at least, *systematically* emerged) from 1968 in the US and

514 I.e., formulas can also prescribe *ranges*.

515 Reuven S. Avi-Yonah, Kimberly A. Clausing, and Michael C. Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split," *Florida Tax Review* 9, no. 5 (2009), 516-517.

516 Schoueri, *op. cit.*, 690-716.

517 *Ibid.*, 690-716.

518 As discussed in: Weiss de Resende, *op. cit.*, 336–344.

between the late 1970's and the 1980's elsewhere, with the advent of the traditional transfer pricing methods[519]. Hence, to sustain that *solely* that understanding of comparability reflects the arm's length nature of a certain profit allocation mechanism or exercise is to say that no ALS existed *prior* to 1968 - we cannot agree with this statement.

We go further - as extensively debated, this traditional, narrow, understanding of the term 'comparability' actually (and pragmatically) *reigned* for a very short period of time. The 1988 US White Paper and the 1995 OECD Transfer Pricing Guidelines quickly embodied the recognition of the incompleteness of the comparability understanding encapsulated within the traditional transfer pricing methods and, while being able to abandon the ALS, opted, instead (as discussed by us under Section 2.1.5), to reshape the ALS contours, including its underlying (now, broader) notion of comparability.

The transactional methods (and the underlying way broader 'comparability' understanding than that Schoueri tries to pass[520]) are already well-established and accepted by the international community. Within this well-established and accepted understanding of arm's length comparability, a *light* FBA would not necessarily fail to fit in/comply with, as a light FBA does accommodate this broader comparability requirements.

By using, for example, a standardized profit margin for routine functions (in connection with a TNMM assessment) or adopting predetermined profit-split formulas for more integrated operations (within a PSM application), the *light* FBA is potentially able to mirror what independent entities would likely achieve in arm's length transactions, aligning it with ALS results. It is, therefore, able to preserve the ALS's core logic while also tackling the *randomization* problem.

As such, we also disagree with attacks which state that FBA would necessarily lead to *arbitrary* results. This is not to say that such could not happen[521]. A *super hard* FBA would certainly lead to that (if by *arbitrary* those attackers mean results not in line with the ability-to-pay principle[522]).

Well, if to follow that argument, *current* ALS is, paradoxically, largely *non-compliant* with 'itself'. We have extensively addressed (and explained) how the current application of the transfer pricing methods leads to actually *arbitrary* results (following the subjective judgement calls), coming from their *randomness*. Our identified issues or weaknesses of current OECD ALS *variant* transfer pricing methods lead the results

519 Prior to that, as discussed under Section 2.1.4, the arm's length assessment was based on tests of *reasonability* and *fairness*, for example.

520 Schoueri, *op. cit.*, 690-716.

521 Although we argue that the introduction of light FBA in the ALS/transfer pricing *praxis* should *reduce* the *randomization* problem we have identified, it is of course not the same as to argue for the end of each and every uncertainty in, e.g., the definition of the functional profile/activity of the parties involved in the ALS assessment, which would enable a treatment 'A' or 'B' under a FBA dynamics. A level of uncertainty is inherent to any legal provision, the degree to which it is expressed, nevertheless, is the key to the matter. This is also debated in: Avi-Yonah, Clausing, and Durst, *op. cit.*, 516-517.

522 As per what seems to be Schoueri's understanding. *See*: Schoueri, *op. cit.*, 690-716.

to the mentioned arbitrariness (or, rather - *randomness*). A random result can, henceforth, *never* match or mirror the ability-to-pay principle.

In short, light FBA would potentially be *less* arbitrary than current transfer pricing methods.

Another concern regarding the adoption of FBA is in terms of its *iterations* with non-FBA systems (i.e., with current ALS OECD *variant*)[523]. Within their proposal to a formulary apportionment for the US, back in 2009, Avi-Yonah, Clausing and Durst stated that:

> "In a world with both formulary and separate accounting system countries, formulary countries will immediately appear as tax havens from a separate accounting country perspective. For example, a multinational firm operating in both separate accounting and formulary countries would have an incentive to book all their income in formulary countries, as the tax liability in such countries does not depend on the income booked there, but rather the fraction of a firm's activities in that location. Such responses would likely greatly reduce the tax revenues of remaining separate accounting countries."[524]

While relevant, this observation seems only to apply in face of our *super hard* FBA, as both our *hard* and *light* versions would *not* adopt a unitary taxation regime.

Still, the thought that iterations between even *hard* or *light* FBA systems and systems based on current ALS OECD *variant* could somehow result in double taxation or double non-taxation is founded. This *might* happen even with current limited adoption of FBA, as when a given MNE adopts a LVAS approach to price its intra-group services, without the need for a typical TNMM benchmark, but such an approach is not incorporated in the relevant ALS *space* variant of one of the MNE's counterparty.

Yariv Brauner also criticizes the impossibility of a coexistence between the ALS and formulaic approaches, stating that "[t]he key conceptual misunderstanding, however, is the binary view of the choice between the arm's length standard and formulary apportionment."[525]

These iteration's risks are, nevertheless, not exclusive to the FBA *v.* non-FBA situations. *Current* iterations between different ALS *variants* or, better yet, between different, increasingly complex and subjective, applications of even a similar ALS *variant* have, as demonstrated, led to disagreements on the expected arm's length *results*, increased disputes and the same double-taxation/double non-taxation consequences.

As our Section 4.1.2 below, already within our reimagination proposals, will further elaborate on, the adoption of a (*light*) FBA, while not fully solving iteration problems, *mitigate* the issue, setting guidance, best practices. This can have a similar effect, one might expect, to the strong soft-law impact of the OECD Transfer Pricing

523 Avi-Yonah, Clausing, and Durst, *op. cit.*, 516-517.

524 *Ibid.*, 519.

525 Yariv Brauner. "Between Arm's Length and Formulary Apportionment" *in The Allocation of Multinational Business Income: Reassessing the Formulary Apportionment Option*. Ed. Richard Krever and François Vaillancourt. Series on International Taxation, v.76. Wolters Kluwer. 2020: 223.

Guidelines. Naturally, such an impact would be higher or lower depending on how politically influential the adopters of the (light) FBA will be.

Another potential issue with the introduction of FBA to the ALS praxis is the difference in the accounting rules/treatments of the parties involved in the transaction(s)[526], affecting, e.g., the determination of the appropriate tax base[527]. This is indeed a major obstacle that any measure aiming at consolidating MNEs international profits (transfer pricing related or beyond) would face, a great example of that being the OECD Pillar Two[528], as mentioned within our *time* evolution assessment.

This issue is, again, absolutely valid to our *super hard* FBA category, which requires a consolidation of profits, based on our *hard* enterprise approach. The issue loses its relevant in face of our *hard* and *light* FBA, as no consolidation efforts are necessary therein.

Finally, the s*usceptibility to manipulation* is another issue concerning the potential application of the FBA. Nevertheless, in congruence with Avi-Yonah and Benshalom, we believe that the adoption of "difficult-to-manipulate and easy-to-observe factors"[529] can significantly *reduce* manipulation manoeuvre room, improving tax and legal certainty and administrability. On a similar understanding that current ALS variant is more *manipulatable*, Yariv Brauner very interestingly adds that, *in verbis*:

> "Note that the use of economic indicators [*within a formulary apportionment dynamic*] is not intendent for accuracy (an always false goal in this context) but rather for justification, flexibility, and **resilience to abuse**. For these same reasons, formulary apportionment often uses multiple factors, **reducing the opportunities for both countries and taxpayers to manipulate the resulting split**."[530] (*Our addition and highlights*)

Note that, not addressing the current manipulation prone of the ALS OECD *variant* has also additional negative effects upon the capacities of the ALS to cope up with its anti-avoidance role.

In conclusion, it is certain that, within an FBA dynamics, we would still have issues

526 Avi-Yonah, Clausing, and Durst, *op. cit.*, 522.

527 *Ibid.*, 522.

528 OECD, *Global Anti-Base Erosion Proposal ("GloBE") – Pillar Two: Public Consultation Document. op. cit.* The efforts to enable a coherent consolidation of profits across the different units of an MNE, within the context of the minimum global level of taxation, is mirrored also in the EU Directive implementing the OECD Pillar Two initiative, *see*: Council of the European Union. *Directive (EU) 2022/2523 of 14 December 2022 on Ensuring a Global Minimum Level of Taxation for Multinational Groups in the Union. op. cit.*, e.g., Recital (11).

529 Avi-Yonah and Benshalom, *op. cit.*, 391. Although the authors defend their position based on a *hybrid regime* (i.e., the use of formulary apportionment restricted to a *residual* profit allocation exercise) – and we do not side with this path – we believe that the cited contribution of the authors is valid even within a more substantial formulary apportionment solution, applicable to a bigger portion of the profits to be allocated.

530 Brauner. "Between Arm's Length and Formulary Apportionment" *in The Allocation of Multinational Business Income: Reassessing the Formulary Apportionment Option. op. cit.*, 217.

on how well current business realities (in the form of MNEs) are reflected in the profit allocation exercise, but these would *not*, in any way, be bigger than they are within the current ALS practice.

Although FBA alone cannot solve the issues of the insufficiencies of the transfer pricing methods, we will, while presenting the full contours of our proposed arm's length reimagination, discuss how an *integrated* implementation of a *light* FBA and an RBC can contribute to *attenuating* said insufficiencies.

### *3.2.6. Summary*

Following – and related with – the misalignment between the ALS *rationale* and the contemporary economic reality, we have identified the challenges related with the inefficiency, and *insufficiency*, of the transfer pricing methods, as pragmatical expressions of the ALS. Based on the *time* evolution assessment of the ALS, we have demonstrated how a growing lack of comparable permeated the application of the traditional transfer pricing methods (i.e., CUP, RP, CP) and how this phenomenon led to the design of the transactional methods, namely, the TNMM and the PSM, in an attempt to reconquer the lost comparability. The transactional methods, nevertheless, introduced increased subjectivity and complexity in the transfer pricing *praxis*, and yet further challenges (or weaknesses), as presented above. This culminated in what we have called a process of *randomization* of the arm's length *results*, in contrast with a tolerable level of *approximation* of these results.

The challenges associated with the insufficiency of the transfer pricing methods are also reflected in the EU, which tend to render current ALS *variants* non-compatible with EU Law. This non-compatibility is not only related to the CJEU assessments in fundamental freedom cases, as within the realm of the first challenge, but also regarding the prohibition of (fiscal) State aid.

Within the first, it was demonstrated that the lack of comparable, and the responses to it embedded in the transfer pricing methods, leading to the mentioned randomization of the arm's length results, fails to present *objective* and *verifiable* criteria, deemed necessary for the justification of a restrictive arm's length provision within the EU, as in the discussed case law of the CJEU, especially streaming from *SGI*. Secondly, the extrapolation of a tolerable level of approximation – leading to the random results – has had several implications within the cases of (fiscal) State aid, initiated by the EC. In *Starbucks*, *Fiat*, *Apple* and *Amazon*, the insufficiency of the transfer pricing methods led to lengthy discussions on the existence of potential selective advantages granted to these undertakings, trough, e.g., mis-validation of the pragmatical expressions of the ALS in APA processes.

The FBA are alternatives presented to the identified *results* challenges, in the EU and broader, capable of providing the missing verifiable and objective criteria to the ALS *praxis*, and to reduce complexity. The different FBA span yet another *continuum*, from stricter versions, where MNEs are treated as a consolidated unit (i.e., enterprise approach) under a *super hard* FBA, to softer, more tailored applications. The *super* *hard*, *hard* and *light* FBA points within our proposed continuum are distinguished, as mentioned, by two elements: (i) their reliance on either an enterprise or an entity approach and (ii) their orientated goal towards mimicking an *approximate* arm's length-like result, within our delineated understanding of the term.

We have concluded that only a *light* FBA would be compatible with our drawn ALS core. We have discussed several remarked key issues to the introduction of light FBA to the ALS *praxis*, including its argued arbitrariness, potential issues with iterations with current ALS *variants* (non-FBA), potential accounting constrains and raised susceptibility to manipulation. Although acknowledging some reason behind some of the above discussed key issues, we have concluded on the outweighing of the expected benefits of the adoption of a certain light FBA to the ALS *praxis*.

## 3.3. The Increasing Compliance Complexity

The issues related to the insufficiency of the transfer pricing methods and the process of *randomization* of the results obtained from the intra-group transactions, culminate in the increasing *compliance complexity* of the ALS, thus spilling-over in the ALS compliance *core*. This increasing compliance complexity is also not disconnected from the misalignment of a *strict* entity-based ALS with the contemporary business *rationale*. It is also not disconnected, therefore, with the RBC alternatives we have presented under our Section 3.1.4.1. above and with our comments therein in relation to these RBC key issues. Importantly, as we have demonstrated, the compliance complexity of the ALS is additionally stretched by measures proposed as solutions to the ALS challenges, which, in many cases, rather imposes obstacles to an efficient navigation and application of the standard.

This Section 3.3. will further discuss how the ALS became gradually more complex, for taxpayers and tax authorities alike (but not only), and how this renders the ALS an undue administrative burden (or constrain) to its operators. We will also turn to the reflexes of these *undue administrative constrains* in an EU scenario (from where we have even borrowed the highlighted expression), similarly to the structure we have already adopted for our Sections 3.1 and 3.2. above, although our considerations in this Section 3.3. will be comparatively shorter, as most of it will depart from our writings within one or another previous Section. Finally, we shall also turn to the potential alternatives to the increasing ALS compliance complexity and to some of their perceived key issues.

### *3.3.1. The Compliance Issues for Taxpayers and Tax Authorities*

It shall already be clear that the ALS has grown to be significantly *dependent* on the particular facts and circumstances of the case[531], which streams from the *time* evolution assessment we have made but also comes in parallel with the discussed

531 Fleming Jr., Peroni and Shay. "*op. cit.*, 171. *See also*: Avi-Yonah, and Benshalom, *op. cit.*

insufficiencies of the transfer pricing methods above. As a direct consequence, (current OECD *variant* of) the ALS *cannot* be effectively managed by taxpayers and tax authorities alike. This is also reflected in the surge of disputes related to the ALS, which are increasingly expensive and time-consuming for the parties involved[532].

Moreover, under this increasing compliance complexity scenario, MNEs are deemed to incur in significant higher compliance costs (overall, *constraints*) than *comparable* unrelated parties. Even within an *unabridged levelling*[533] comparison, such disadvantageous position of MNEs is only necessary (to the ALS objectives) up until a certain level of reasonability/proportionality (especially sensitive when such objectives, or roles, are also not been achieved, as we will turn to under Section 3.4 below). The perceived unreasonableness and lack of *proportionality* was also subject to the scrutiny of recent case law[534].

Based on our ALS compliance *core*, we conclude that excessive administrative burden makes the analysed *variant* non-compatible with the standards' contours and, as such, must be addressed.

The Section below will present the reflexes of that potential incompatibility with the EU Law.

### *3.3.2. The Barriers to the EU Fundamental Freedoms*

#### *3.3.2.1. The Undue Administrative Constrains*

Once again, we turn to the assessment of our base *SGI* para. 71 as our departing point for the analysis of the *justifications*, at this stage related to the ALS *compliance* core, of the *a priori* restrictive ALS. The CJEU in the mentioned case states that, in *verbis*:

> "National legislation which provides for a consideration of objective and verifiable elements in order to determine whether a transaction represents an artificial arrangement, entered into for tax reasons, is to be regarded as not going beyond what is necessary to attain the objectives relating to the need to maintain the balanced allocation of the power to tax between the Member States and to prevent tax avoidance where, first, on each occasion on which there is a suspicion that a transaction goes beyond what the companies concerned would have agreed under fully competitive conditions, the taxpayer is given an opportunity, without being subject to **undue administrative constraints**, to provide evidence of any commercial justification that there may have been for that transaction."[535] (*Our highlight*)

532 Fleming Jr., Peroni and Shay. "*op. cit*., 171. *See also*: Avi-Yonah, and Benshalom, *op. cit*., 171.

533 Term as we have repeatedly used above. *See*: Navarro, *op. cit*., 361.

534 We will also turn to the cases and underlying issues around this term in an EU context under our Section 3.3.2 below.

535 CJEU, *Société de Gestion Industrielle v. Etat belge*, *op. cit*., §71.

We have previously analysed *SGI*'s meaning of both the 'any commercial justification' and the 'objective and verifiable' elements, respectively within our arm's length *rationale* and *results* assessments. We will turn to the ALS's requirement of not subjecting the taxpayer to *undue administrative constrains*, as per our above highlight, and to how these relate to the standard's increasing compliance complexity. Finally, the ALS capabilities of fulfilling its roles as to 'maintain the balanced allocation of the power to tax between the Member States and to prevent tax avoidance' will be discussed under Section 3.4 below.

*SGI*'s para. 75[536] (and, later on, *Hornbach-Baumarkt*'s para. 57[537]) consider the analysed ALS variants to pass their proportionality tests (within the *justifications* assessments), provided that the respective referring courts (i.e., Belgian and German) verify, *de facto*, whether the taxpayers were "given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that transaction."[538]

Although AG Kokott did not significantly add to this particular discussion in her opinion to *SGI*[539], AG Bobek, within his opinion to *Hornbach-Baumarkt*, presented quite a controversial opinion stating that "the [*proportionality*] question is a binary one. It would be a recipe for extreme legal uncertainty if alleged practical difficulties in relation to the application of that principle to very specific cases (…) were to constitute valid grounds for rejecting it as disproportionate."[540] (*Our highlight*)

We cannot side with AG Bobek's opinion. Rigorously, based also on our considerations made so far and especially in relation to those within this Section, it seems that current increased compliance complexity, in face of any such *evidence* (even if directly related to a transfer pricing method application, in a more straightforward case than ours *SGI* and *Hornbach-Baumarkt*), is never unaccompanied by a *significant* administrative constraint. A such, the question is *not* binary, as put by AG Bobek (i.e., *is* or *is not* the arm's length proportional[541]). According to our *space variants* analysis, many are the possible expressions of the ALS and, as such, the MS legislations eventually under scrutiny are specific pieces of law, which contain *specific* implementations of the ALS. It is thus imperative to assess, for the fundamental freedoms' cases, the

536 CJEU, *Société de Gestion Industrielle v. Etat belge*, *op. cit*., § 75.

537 CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit*., § 57

538 CJEU, *Société de Gestion Industrielle v. Etat belge*, *op. cit*., § 75. The wording used in *Hornbach-Baumarkt* is slightly different, *in verbis*: "In the present case, it is for the referring court to determine whether Hornbach-Baumarkt AG was in a position, without being subject to undue administrative constraints, to put forward elements attesting to a possible commercial justification for the transactions at issue in the main proceedings, without it being precluded that economic reasons resulting from its position as a shareholder of the non-resident company might be taken into account in that regard." CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit*., § 57

539 Kokott, Opinion in *Société de Gestion Industrielle (SGI) v. État belge*, *op. cit*.

540 Bobek, Opinion in *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit*., § 110.

541 *Ibid*., § 110.

specificities of the case and whether that ALS is potentially unproportional, in *SGI*'s para, 71 terms[542].

We conclude, henceforth, that the current OECD ALS *variant* should have *failed* the proportionality test, within a justification's assessment, given the undue administrative constraints imposed on taxpayers to provide for evidence of the commercial justifications of their transactions, even if this evidence revolves around the mere application of transfer pricing methods.

In addition, the lack of more systematic introduction of *light enterprise* elements and the discussed RBC *praxis* makes the provision of such *evidence* by taxpayers a herculean task for cases involving group interests (i.e., certain types of *conditions*), as in *SGI* and *Hornbach-Baumarkt*. We would only expect a passing in the proportionality test had the ALS *variant* comprised both elements of FBA, for the evidence of the mere application of transfer pricing methods, in many cases, and of RBC, for the provision of such *evidence* in cases of *some* not priced *conditions*, as in *SGI* and *Hornbach-Baumarkt*, as well as *simplification* mechanisms to work alongside the formers.

We will further elaborate on the desirability of a joint adoption of these measures under our Chapter 4 below.

### *3.3.3. The Simplification Safeguard Mechanisms*

Simplification safeguard mechanisms comprise a series of potential solutions to the identified increasing compliance complexity of the ALS, which are already solidified in many jurisdiction's transfer pricing requirements (or among several arm's length *space variants*), where a multitude of safeguards are present. We see these potential solutions grouped in *three* broad categories.

Firstly, we have those which are under the FBA realm, through the application of formulas (within our assessment of the term) to simplify certain aspects of the ALS operations. In that sense, all FBA are deemed to, somehow, serve this simplification purpose, as we have had the opportunity to present under Section 3.2. above. Against those who would dispute otherwise, we stand with Yariv Brauner, who once stated that:

> "Formulary apportionment also simplifies the administration of transfer pricing, since it avoids the costly and complex comparability analysis, replacing it with compilation of data that the taxpayer should possess in any event. Opponents of formulary apportionment often counter this argument with the argument that the eventual rules applying formulary apportionment will be as complex as the arm's length standard rules, because they will need to fend off the inherent imprecision of the definitions (of the formula factors), timing issues, and valuation much like the current arm's length standard rules. To some extent this critique is correct, yet once cannot avoid the fact that the 'degrees of freedom' [*judgement calls*] in the comparability analysis and the inevitable reliance on [*hard*

542 CJEU, *Société de Gestion Industrielle v. Etat belge*, *op. cit.*, § 71.

> *to get/verify*] external data (rather than internal firm data) that is often inaccurate and incomplete mandate unquestionably more complex and vague costlier norms for the arm's length standard."[543] (*Our highlights*)

These simplification safeguard mechanisms (*already*) exist to reduce arm's length related compliance complexity, for taxpayers and tax administrations alike, which we have also framed within the lines of the *undue administrative constraints*, as addressed by the CJEU. As stated by Yariv Brauner above[544], while (aiming at) ensuring a reduced compliance complexity, a simplification safeguard mechanism must, additionally, bring at least the *same* level of legal certainty as verified *prior* to its introduction. Simplification safeguard mechanisms that increase legal uncertainty are condemned to fail its purpose, as already clearly noted by Gustavo Resende[545].

Secondly, we have simplification mechanisms in the form of specific exemptions or limited (comparatively wise) ALS related compliance obligations. Thirdly and lastly, we have those, which are indeed very much related to the second, that are actually tools to *enable* the application/kicking-off of the second[546].

The Sections below will explore our second and third categories, while the first is already significantly addressed within our Section 3.2. above.

### *3.3.3.1. The Compliance Simplification Safeguard Mechanisms*

Within this category are the rules which determine thresholds (or terms) as to when arm's length compliance is *not* required, e.g., excluding small taxpayers or transaction of lower amounts from documentation requirements. Such thresholds (or terms) can be further divided in three groups. The first group includes thresholds for the exemption of compliance with the ALS in itself (i.e., *substance* exemptions). The second foresees exemptions from the ALS *formal*/documentation requirements, while the third group excludes taxpayers from certain steps within the application of the transfer pricing methods/testing *steps* in the economic analysis.

In the first group, certain taxpayers are excluded from the obligation to even

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543 Brauner. "Between Arm's Length and Formulary Apportionment" *in The Allocation of Multinational Business Income: Reassessing the Formulary Apportionment Option*. *op. cit*., 219. A few comments from our side are, though, relevant. Firstly, it seems that Yariv Brauner uses the term comparability in a rather narrow sense – our light FBA would still encompass a broad view of comparability, i.e., intending to mimic an ALS-like result. Secondly, as we also apply a broader understanding of the term 'formula', it might be that, in some cases, although simplified, external data is needed (e.g., as in pre-established/pre-prepared TNMM standard benchmarks).

544 *Ibid*., 219.

545 Weiss de Resende, *op. cit*., 336–344.

546 These "categories" of safeguards are also presented by Chand, Turina and Ballivet, "Profit Allocation within MNEs in Light of the Ongoing Digital Debate on Pillar I – A "2020 Compromise"? From Using a Facts and Circumstances Analysis or Allocation Keys to Predetermined Allocation Approaches", *op. cit*., 571., although the authors seem not to split our second and third categories.

comply with an existing ALS *variant*. This is commonly illustrated in the case of jurisdictions *a priori* excluding purely domestic groups from the ALS observance requirement. This seems to be the case, e.g. in France and its current Art. 57 of the *Code Général des Impôts*[547]. The OECD Transfer Pricing Guidelines in itself, although not with the hard-law authority, also focused on the ALS observance limited to international situations[548].

In the second group, taxpayers are excluded only from all or some formal/documentation requirements related to the ALS. This is especially common in the introduction of domestic thresholds for the requirements to prepare and/or submit local files, master files or equivalents. In Lithuania, for example, taxpayers with turnovers below 15 and 3 million Euros in the year preceding the analysed period are not subject to the requirement to *prepare*, respectively, master file and local file[549]. Similarly, in the neighbouring Latvia, *submission* exemptions apply to turnovers below 15 and 5 million Euros in the preceding the analysed period, although other requirements exist[550]. These same jurisdictions have second group thresholds also to exempt certain transactions from the ALS formal compliance, when (despite some exceptions) below 90 and 20 thousand Euros in the analysed year, respectively[551].

The OECD in itself has explicitly adopted such second group thresholds in, e.g., the non-application of Country-by-Country reporting obligations to MNEs with annual consolidated revenues below 750 million Euros[552].

Finally, the third group, concerning the exclusion of taxpayers from *certain steps* within the application of the transfer pricing methods/testing in the economic analysis can be well exemplified by the LVAS approach, as i.e., a benchmark study preparation is not required within an OECD TNMM-like assessment. Although we have talked about the LVAS approach within our FBA assessment and within our first category herein, it can also be placed here, under this third group, as it contains requirements

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547 France, *Code Général des Impôts*, Article 57, modified by Law No. 2023-1322 of 29 December 2023, art. 116 (V).

548 "The domestic issues are not considered in these Guidelines, which focus on the international aspects of transfer pricing." OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*, § 12. Although this statement could be "too little" to ascertain that the Gudelines aim would be to exclude purely domestic situations from the ALS observance obligation.

549 Republic of Lithuania, Minister of Finance, *Order on the Approval of Article 40(2) of the Republic of Lithuania Law on Corporate Tax and the Rules for the Implementation of Article 15(2) of the Republic of Lithuania Law on Personal Income Tax*, No. 1K-123 of 9 April 2004, Art. 85(1).

550 Republic of Latvia, *On Taxes and Fees*, amended 20 February 2020, entered into force 19 March 2020, Section $15^2$ (3).

551 Republic of Lithuania, Minister of Finance, *Order on the Approval of Article 40(2) of the Republic of Lithuania Law on Corporate Tax and the Rules for the Implementation of Article 15(2) of the Republic of Lithuania Law on Personal Income Tax*, *op. cit.*, Art. 87(2) and Republic of Latvia, *On Taxes and Fees*, *op. cit.*, Section $15^2$(11).

552 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*, § 5.52.

(i.e., thresholds) on to which transactions it should be applied.

We conclude, hence, that the compliance simplification safeguard mechanisms are not only compatible with the ALS (rather than necessarily exceptions to it) but are embedded in the ALS *praxis*. Beyond that, they are necessary to alleviate the undue administrative constraints which arise from an increasingly complex ALS. A *reimagined* ALS, as we will shortly turn to, shall benefit from a more structural introduction of these mechanisms.

#### *3.3.3.2. The Compliance Simplification Safeguard Mechanisms Enabling Thresholds*

Under this third category, the mechanisms work as a determination of the thresholds for the 'kicking-in' of eventually adopted FBA (i.e., the taxpayers which are entitled to access the reduced compliance benefits of the mechanisms available under the first and second categories which we have presented). As such, they are intrinsically linked to the fits and second categories.

As an example, the mentioned Lithuanian threshold for the local file preparation obligation exemption is regulated (kicked-in) once an enabling threshold is met (i.e., 3 million Euros)[553]. Similarly in that jurisdiction, the exemption of the formal compliance requirements for *certain* transactions, even for taxpayers not exempt from the local file preparation is kicked-in once these transactions meet the below 90 thousand Euros enabling threshold[554].

These enabling thresholds are, therefore, important for the adequate operation of the safeguard simplification mechanisms and shall also be debated within our reimagination proposal, under Chapter 4 below.

#### *3.3.3.3. Key Issues with the Simplification Safeguard Mechanisms*

This Section analyses the key issues from *two* perspectives.

The key issues affecting our first category – related to the FBA – were already extensively presented under our Section 3.2.5.4 above and translate, here, in a potential crossing of the line between a *light* FBA compatible solution and a *hard* FBA. In other words, an oversimplification could be prone to hinder a sufficient, practically expressed, concern with the achievement of an ALS-like result, thus risking compatibility with our drawn ALS *core*. Full elimination of any potential (compliance) complexity within an ALS *praxis* shall not be a (realistic) goal, therefore, of any proposed solution to the ALS identified challenges and such understanding/concern will be reflected in our proposed *reimagination* exercise under Chapter 4.

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553 Republic of Lithuania, Minister of Finance, *Order on the Approval of Article 40(2) of the Republic of Lithuania Law on Corporate Tax and the Rules for the Implementation of Article 15(2) of the Republic of Lithuania Law on Personal Income Tax*, *op. cit*., Art. 85.4.

554 *Ibid.*, Art. 87.2.

The key issues affecting both our second and third categories above identified[555], in a combined way, given their intrinsic relations, are mostly related to the establishment of potential undesired *economic distortions*. In case exceptions to ALS compliance requirements might nurture possibilities for transfer pricing manipulations, with less information readily available to tax authorities. Ultimately, this can lead to an actual inobservance of the ability-to-pay principle and a practical non-compliance with the ALS *core*. A reimagination exercise to the ALS must, inevitably, carry this concern.

### *3.3.4. Summary*

As we have noted, the insufficiency of the strict entity approach, of the transfer pricing methods, and the consequent randomization process of the arm's length results further leads to an increased compliance complexity. Beyond creating significant obstacles to an efficient application of the ALS, the increased compliance complexity creates *undue administrative constrains* which, following the assessed case law of the CJEU in the EU, might render the ALS non-compatible with the EU Law.

As measures to tackle the identified challenges, the simplification safeguard mechanisms were presented, structured in three broad categories: (i) the compliance simplification safeguard mechanisms, (ii) the compliance simplification safeguard mechanisms *enabling thresholds*, and (iii) those related with the FBA, as already addressed in Section 3.2 above. Key issues identified with the analysed categories resolved around potential undesired economic distortions and, ultimately, to a lack of observance to the ability-to-pay principle, items which must be considered when of the introduction of simplification safeguard mechanisms in the ALS *praxis*.

## 3.4 The Inefficiency of the Arm's Length Roles

Based on the *time* evolution assessment of the ALS, and according to our then established arm's length *core*, the standard must necessarily be targeted to/comply with both the *profit allocation* and the *anti-avoidance* objectives[556]. Although we have verified that under the early ages of the ALS evolution only the first was an underlying goal of arm's length, the second was rapidly recognized by the arm's length operators and it is not an exaggeration to state that such is a pivotal objective of the arm's length for many decades, and even more so after the advent of the BEPS project.

While the attainment of the first ALS goal is rather easy to verify, the challenges to the application of the arm's length standard, especially those which we have already turned to, revolving around the standard's core *rationale*, *results* and *compliance*

555 *Vide* Sections 2.2.4.1 and 2.2.4.2.

556 As we have discussed under Sections 2.2.4.3. and 2.2.4.4, both the *taxing rights redistribution* and the *anti-tax competition* objectives are perceived as *optional* to the arm's length standard, potentially to be verififed in practice depending on the future developments of international tax law. As such, they will not be assesed under this Section.

*requirements*, have led, as we have thoroughly demonstrated, to an ineffective (*insufficient*) application of the ALS. A natural corollary of said insufficiency is the inefficiency of the arm's length role as an anti-avoidance mechanism.

Said inefficiency can be demonstrated merely by the pointing out of the existence/increased propagation of a multitude of *general* and *specific anti-avoidance measures*, in the international tax *praxis*[557], working alongside current ALS OECD *variant*-based transfer pricing rules. An excellent example of that insufficiency (paired with the need of additional measures alongside the transfer pricing rules) is the recent *X BV* case in the CJEU[558].

The case consisted of X BV, a Dutch company that financed the acquisition of shares in a related company through a loan from another group entity, hence, all companies involved belonged to the same multinational group[559]. Under the applicable Dutch corporate tax law, interest on such intra-group loans were generally non-deductible when the loan was used to acquire shares in a related entity, based on a *juris tantum* presumption of abuse (i.e., that such transactions may constitute wholly artificial arrangements aimed at obtaining tax advantages). Consequently, the same Dutch corporate tax law provision foresaw exceptions to the denial of deductibility for such cases if the taxpayer could demonstrate that the loan and related transaction were based on sound business reasons or that the interest was taxed at certain rates at the level of the creditor[560]. *X BV* challenged the application of this anti-abuse rule, arguing it infringed its freedom of establishment under EU law, given its argument that the loan was carried out *at arm's length*[561].

The CJEU was left with the task of evaluating whether the imposition of an additional anti-avoidance measure (such as the *juris tantum* Dutch interest limitation rule), applied concomitantly with a transfer pricing/arm's length provision would create a unproportional restriction to the taxpayer's fundamental freedoms[562], as the justification was grounded precisely in the well-established (also within EU case law) of our second ALS role (*anti-avoidance*).

In its decision to the case, the Court did not see the unproportionally of the joint application of the (specific) anti-avoidance measure at stake and the transfer pricing rules, stating that, *in verbis*:

557 As an example, *vide* the EU Anti-tax Avoidance Directive compilation of such measures: Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, *Official Journal of the European Union* L 193/1, 19 July 2016.

558 Court of Justice of the European Union (CJEU). *Judgment of the Court (First Chamber) of 4 October 2024 – X BV v. Staatssecretaris van Financiën* (Case C585/22), ECLI:EU:C:2024:812, § 4-6.

559 *Ibid.*, § 4-6.

560 CJEU, *Judgment of the Court (First Chamber) of 4 October 2024 – X BV v. Staatssecretaris van Financiën*, *op. cit.*, § 7-10.

561 *Ibid.*, § 8 and others.

562 CJEU, *Judgment of the Court (First Chamber) of 4 October 2024 – X BV v. Staatssecretaris van Financiën*, *op. cit.*, § 62 ff.

> "In the light of all of the foregoing, the answer to the questions referred is that Article 49 TFEU must be interpreted as not precluding national legislation under which, in the determination of a taxpayer's profits, the deduction of interest paid in respect of a loan debt contracted with a related entity, relating to the acquisition or extension of an interest in another entity which becomes, as a result of that acquisition or extension, an entity related to that taxpayer, is to be refused in full, where that debt is considered to constitute a wholly artificial arrangement or is part of such an arrangement, **even if that debt was incurred on an arm's length basis** and the amount of that interest does not exceed that which would have been agreed between independent undertakings."[563] (*Our highlights*)

The extract above highlights that, although not *explicitly*, the CJEU recognizes the insufficiency of the arm's length standard to ensure its anti-avoidance role (or, in CJEU terms, *justifications*). We believe that a *reimagination* of the ALS could/should be able to reduce such insufficiency and underlying need for auxiliary/support measures, although, given the constrains of our feasibility framework, it is hard to predict whether a complete independent efficiency could be achieve as to entirely preclude the need for additional anti-avoidance measures – this will have to be progressively accessed in case of implementation of our proposed solutions.

## 3.5. The Conflicts of Different Arm's Length Standards

### *3.5.1. The Increased Transfer Pricing Disputes*

The existence of potential different standards (*not* at arm's length) for the fulfilment of what is the original *role* of the arm's length standard, i.e., the allocation of taxable profits between the constituent units of MNEs – would inevitably lead to the *widespread* of cases of double-taxation, in a situation which would be marked by a strong international/global *uncoordination* in the frames of what we have already discussed above and, thus, contrary to the arm's length *core*[564].

This was noted since the times of the Carroll Report[565] and is a clearly reflected in the authoritative statement of the ALS, under Art. 9 of the OECD Model Tax Convention[566] and its commentaries, as well as in the preface of the OECD Transfer Pricing Guidelines[567].

The existence of several different standards, yet *within* an arm's length logic (i.e., different *space variants*), although a step towards our *semi-coordinated* nature, does not

563 CJEU, *Judgment of the Court (First Chamber) of 4 October 2024 – X BV v. Staatssecretaris van Financiën*, *op. cit*., § 93.

564 *Vide* Section 2.2.5.1 above.

565 Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, *op. cit*.

566 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017. op. cit*., Art. 9.

567 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit*., Preface, § 6.

*necessarily* achieve a complete elimination of the double-taxation risk, being the contemporary reality underlying the ALS *praxis*. As such, the more far off from each other the different ALS *space variants* are, the higher are the expected conflicts/disputes and double taxation, having, consequently, higher chances of inobservance of the arm's length *core*. These conflicts/disputes are valid for ALS *variants* based on current OECD grounds, but also, as highlighted by Turina, may arise in case of iterations between these and potential ALS *variants* which adopt safeguard/simplified approaches (within our definition of *formulas*)[568], although we see the latter to be less prevalent, if within our proposed solution outlines, as we will further explore under our Chapter 4.

Case law can easily illustrate the first order/set of conflicts (i.e., between different OECD-based ALS *variants*, understandings), the current TNMM and PSM application issues, as discussed, respectively, under Sections 3.2.1.2 and 3.2.1.3 above, being great examples of the consequences of a *lack of coordination* on, e.g., the elements to the application of the transfer pricing methods.

### *3.5.2. The Barriers to the EU Fundamental Freedoms and the EU (Fiscal) State Aid Issues*

As stated in the TFEU, *direct* taxation (and hence, the arm's length standard) fall under the competence of the Member States, although they must exercise such competence in accordance with the EU Law, as long rooted in the case law of the ECJ (now, CJEU)[569]. Therefore, lack of *full*-coordination or, herein, *harmonization*, is not perceived as deeming a certain *direct* taxation provision as contrary to the EU Law, a statement which goes together with our understanding that a *semi*-coordination nature is not *necessarily* against the core of the arm's length standard.

On the other hand, as we have demonstrated above, the closer to a *full* coordination state, the less likely conflicts/disputes are to arise which, in a EU Law language, could be translated into less obstacles to the economic integration of the Member States and to their exercising of the fundamental freedoms, especially the free movement of establishment, which we have already discussed along this study. Higher coordination is, as such, although not *legally* necessary, *desired* for the improvement of the efficiency of the arm's length standard in the region and for the Union's fulfilment of its existential goals.

In this regard, as we will analyse below, the EU has intensified its proactiveness in introducing measures targeting an *increased* coordination, especially through the work of the EC – firstly, the EC Notice and, more recently, with the publication of the Transfer Pricing Directive Proposal.

In the realm of fiscal State aid, having a more coordinated arm's length standard (less reliant on *ex-post* coordination measures, such as APA, as we will soon explore)

568 Alessandro Turina, "Back to Grass Roots: The Arm's Length Standard, Comparability and Transparency – Some Perspectives from the Emerging World," *World Tax Journal* 10 (2018), 341.

569 *Vide* cases cited under Section 3.2.4.2 above.

can also lead to a reduction of (*significant*) disputes, as the ones we had in the EC investigations of *Starbucks*[570], *Fiat*[571], *Apple*[572] and *Amazon*[573]. Again – although not likely to render the arm's length incompatible with EU Law (as we have concluded for the challenges affecting the *other* of its core elements), the lack of enhanced coordination can (as it already does) render the ALS less efficient.

### *3.5.3. The Increased Coordination Solutions*

Given the challenges identified, the increased coordination solutions, i.e., steps towards a *full* coordination nature of the arm's length standard *variants*, are necessary. These solutions can be shaped/presented in different ways, which can be categorized under *ex-post* and *ex-ante* coordination efforts[574]. From a general/international standpoint, these will be presented, respectively, as the APA, Mutual Agreement Procedures (**"MAP"**) and court decisions, and as the potential improvements to both the OECD Model Tax Convention[575] and the OECD Transfer Pricing Guidelines[576]. From an EU perspective, the first category will be analysed from the prism of the EC and the courts decisions, while the second category will be analysed through the lens of a potential EU transfer pricing minimum standard, as proposed under the Transfer Pricing Directive Proposal[577].

#### *3.5.3.1. The Ex-Post Increased Coordination Solutions*

Within the first, *ex-post*, category, both APAs, as we have discussed, and the MAP, as foreseen under Art. 25 of current OECD Model Tax Convention[578], are tools which

570 EC, *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks*. *op. cit*.

571 EC, *Commission Decision (EU) 2016/2326 of 21 October 2015 on State Aid SA.38375 (2014/C ex 2014/NN) Implemented by Luxembourg to Fiat*. *op. cit*.

572 EC, *Commission Decision (EU) 2017/1283 of 30 August 2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) Implemented by Ireland to Apple*. *op. cit*.

573 EC, *Commission Decision (EU) 2018/859 of 4 October 2017 on State Aid SA.38944 (2014/C) (ex 2014/NN) Implemented by Luxembourg to Amazon*, *op. cit.*

574 For the purpose of this analysis, the term *ex-post* is to be understood as something which happens after the *knowledge* of a certain factual circumstance, incl. the design (prior to implementation) of a tax model, structure, etc. The expression *ex-ante* is to be understood as the opposite of *ex-post*, as described in this footnote.

575 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*. *op. cit*.

576 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*. *op. cit*.

577 EC, *Proposal for a Council Directive on Transfer Pricing Rules and on a Common Framework for Transfer Pricing in the European Union*, *op. cit*.

578 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017*. *op. cit*., Art. 25.

have been (*rightfully*) developed, especially following the BEPS Project[579], to mitigate the negative effects (i.e., double taxation) of the *semi-coordination* nature of current ALS *praxis*. Similarly, under an EU scenario, the EC decisions, especially in the realm of the prohibition of (fiscal) State aid and the case law of the CJEU represent the *ex-post* set of solutions, locally applied.

Recognizing their importance, we believe, nevertheless, on a *more coordinated* arm's length nature *less reliant* on those *individual*, *administratively burdensome* and *ex-post* measures and on a heavier reliance *on standardized simplified approaches*. The latter being a primary line of defence against the undesired double-taxation and, the firsts, relegated to a more *exceptional/reduced* role[580], as we will shortly turn to.

### *3.5.3.2. The Ex-Ante Increased Coordination Solutions*

Acknowledging that, despite the traditional bilateral structure of the arm's length standard, as showcased in our *time* evolution assessment, the role of the OECD and its soft law instruments is of fundamental (*practical*) importance to the arm's length *praxis*, we believe that these instruments are the most appropriate forums for introduction of, in our terminology, *ex-ante* increased coordination measures for the arm's length standard.

This understanding, we must point out, is not in any way a novelty. The periodically reinforced, to say so, commentaries to the authoritative statement of the arm's length standard, under Art. 9 of the OECD Model Tax Convention, represents further tacit political agreements, contributing to a more coordinated application of the ALS. A perhaps much clearer example of those steps towards increased coordination is the OECD Transfer Pricing Guidelines, which also periodically incorporates suggested changes to the ALS which are commonly implemented/followed by different jurisdictions[581].

Naturally, the *way* under which the latter is done in practice still leaves room for, as discussed at the beginning of our considerations around this topic, the existence of actually quite divergent *variants* of the ALS, based on such suggested changes. The problem does not necessarily lie in the forum, but in the way the measures are constructed.

Finally, better would be, as we will discuss below based on the EU example, that such *ex-ante* solutions would also be adopted within *hard law*/ legally binding

579 The latter directly as a corrolary of Action 14: Organisation for Economic Co-operation and Development (OECD). *Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report*. Paris: OECD Publications, 2015.

580 With us in this tought also: Turina, *op. cit*., 336-339. Further data on the MAP statistics, in OECD jurisdictions, which could offer guidance to an exceptional application of this *ex-post* measure can be found *in*: Organisation for Economic Co-operation and Development (OECD). *Making Dispute Resolution Mechanisms More Effective – Consolidated Information on Mutual Agreement Procedures 2025*. Paris: OECD Publications, 2025.

581 A successful example of that being the LVAS regime, *see*: OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit*., § 7.43 ff.

instruments, i.e., the *actual* double tax treaties and, when possible, under multilateral treaties.

#### *3.5.3.3. The European Arm's Length 'Minimum Standard' Alternative*

The creation of an EU arm's length minimum standard will be presented, following the path currently led by the EC Transfer Pricing Directive Proposal, under our Chapter 4 below, as part of the implementation outlines of our reimagined arm's length standard, as a potentially efficient *ex-ante* increased coordination solution.

#### *3.5.3.4. Key Issues with the Increased Coordination Solutions*

Although we advocate for the implementation of strong *ex-ante* increased coordination solutions, we understand that these would imply in political constrains, which could potentially impair short to mid-term implementation of such measures. To mitigate these risks, as Chapter 4 will further turn to, a few possibilities can be raised. Initially, changes shall *not* wait for a *global consensus* to be implemented – they can be put forward in the mentioned OECD *soft law* instruments and, in other cases, even agreed on bilaterally by economically close jurisdictions, directly as part of their double taxation treaties (e.g., in the form of annexes thereto). Such constrains are even smaller in the EU, given the enhanced integration found therein.

These issues, therefore, although relevant, are not to be seeing as impeditive of the implementation *of ex-ante* solutions.

On a second perspective, the use of APA and MAP (*ex-post* solutions) as the primary line of defence against the issue of double-taxation, as we have presented under Section 3.5.1 above, is not ideal, especially due to the mentioned individual, administratively burdensome and *ex-post* natures. These mechanisms usually fail to provide for a strengthened *semi-coordination*, as exemplified in *India vs AON Consulting Pvt. Ltd.*[582].

In the mentioned case, the taxpayer provided services such as human resources consulting services, payroll processing, business process outsourcing, and software development services to related parties[583]. The Indian tax authority argued for transfer pricing adjustments based on two *streams*: US and non-US transactions[584], basically arguing for a similar solution for the later as applied to the former, the issue being that the former solution was arrived at through a MAP procedure carried out between the Indian and the US authorities[585]. The Court decided that "[a]n agreement arrived at by the competent authorities of two contracting states under MAP cannot substitute the determination of [arm's length standard] under the Act and the Rules [Indian

582 Delhi High Court. *India v. AON Consulting Pvt. Ltd.* ITA 244/2024 (February 2025).

583 *Ibid.*, § 6.

584 *Ibid.*, § 8.

585 *Ibid.*, § 11.

domestic legislation] in cases which are not covered under the MAP"[586] and, therefore, "the decision (…) to direct the determination of the [arm's length standard] for Non-US Transactions on the basis of the framework as agreed to by the competent authorities under MPA for US Transactions, is not in accordance with the law and, thus, the said decision cannot be sustained"[587].

Despite the issues with the application of both APA and MAP and the potential successful increased coordination reflected in both the OECD Model Tax Convention and the OECD Transfer Pricing Guidelines, as discussed above, the formers shall still retain an exceptional (rather, *residual*) application.

Such application is deemed necessary in cases dealing with issues *not* (possibly) addressed by standardized simplified approaches, e.g., when the parties/jurisdictions involved disagree on the nature/classification of the transaction at issue. These cases are intrinsically related to the endeavours of the *accurate delineation* of the transactions, as we have discussed under Section 3.2.1.2. As these endeavours' challenges would hardly be completely addressed within any reimagination exercise for the ALS, both APA (especially the bilateral and multilateral versions) and MAP's importance would be retained for such situations.

In the recent *Australia* v. *Oracle Corporation Australia Pty Ltd*[588], the role of the court's decision was also retained, as, there, the taxpayer was not able to proceed with the MAP and stay judicial procedures concomitantly initiated, given the foreseen implications of a decision to other similar cases, in attention to the public interest[589]. This reveals that also the role of the *courts* is ought to be maintained as an additional *exceptional/residual* role for coordination purposes[590].

### *3.5.4. Summary*

Having identified the existence not of a single ALS, but rather of several *time* and *space* variants thereof and, naturally, the existence of non-arm's length solutions to the exercise of allocation of taxable profits between the constituent units of MNEs, leading to different levels of coordination in the adopted solutions, we have also identified potential challenges arising from these iterations. These challenges can lead to instances of double-taxation.

Although, within an EU context, a lack of full coordination is not deemed contrary to the EU Law in its current stage of integration regarding direct taxation, we

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586 Delhi High Court. *India v. AON Consulting Pvt. Ltd., op. cit.*, § 36.

587 *Ibid.*, § 37.

588 Federal Court of Australia. *Australia v. Oracle Corporation Australia Pty Ltd.* [2024] FCA 1262. October 2024.

589 *Ibid.*, § 82-86.

590 In the *Australia v. Oracle Corporation Australia Pty Ltd* case, to have a more coordinated understading of the term royalties for the sake of the application of the double-tax treaties celebrated by Australia. *Australia v. Oracle Corporation Australia Pty Ltd*, op. cit., § 83.

acknowledge that a higher degree of a semi-coordination is desired. A higher level of semi-coordination can, indeed, attenuate obstacles to the exercising of the fundamental freedoms, but also help to reduce disputes, such as the ones within the (fiscal) State aid cases discussed above.

As alternatives (instruments) towards a higher coordination nature between the different arm's length standards, the increased coordination solutions are presented in two categories: (i) the *ex-post* increased coordination solutions, and the (ii) *ex-ante* increased coordination solutions. The first category includes APA and MAP while the second category includes reinforced OECD Transfer Pricing Guidelines and Model Tax Convention. From an EU perspective, as mentioned, the first category is analysed from the prism of the EC and the courts decisions, while the second category through the lens of a potential EU transfer pricing minimum standard.

Despite issues related to *political* and *consensus* constrains, we have concluded that these are not impeditive to the implementation of the *ex-ante* measures, while, due to high *in casu* administrative constrains, *ex-post* measures must retain an exceptional (rather, *residual*) application – *necessary*, as presented above, but expectedly less resorted to in a broader context of reimagination of the ALS.

# CHAPTER 4. REIMAGINING THE ARM'S LENGTH STANDARD

## 4.1. Proposed Solution

The analysis carried out revealed those that, in the author's view, are the most pressing challenges to an effective application of the ALS and, consequently, to an effective taxation of profits derived from associated parties' transactions. These challenges, as extensively discussed and framed, are intrinsically related to the perceived deficiencies in the different elements to the drawn arm's length's *core*, i.e., rationale, results, roles, compliance requirements and coordination nature.

This *reimagination* Chapter, therefore, proposes to present changes to the ALS *praxis*/operation which are deemed capable of tackling the negative effects (consequences) of the identified challenges.

As stated in the introduction to this work, the proposed solutions/changes are drafted as to fit within our established *feasibility framework*, with the limitations it poses, thus the terminology chosen for this *propositive* endeavour: the *reimagination* of the arm's length standard. This puts us in a *difficult* position, as such limitations are mirrored in obstacles to a *complete* efficiency of our proposals, although our reader was properly alerted of that in the Introduction Section. The reimagination efforts to be presented ahead follow, therefore, a *second-best* logic.

A corollary of that, naturally, is that while some of the challenges would be *mostly* solved, others would only *partially* be, with still some which we believe simply *cannot* be addressed within our feasibility framework. For the last two cases, as we have also shared previously, we are confident that our proposed reimagination exercise would *not* lead to a worse outcome/scenario if compared to *current* OECD ALS *variant*.

Finally, although the challenges presented (and now, *targeted*) are imminently international (rather, *global*) we have turned to several EU-specific repercussions/reflexes of such, i.e., mainly through the prism of the fundamental freedoms and prohibition of (fiscal) State aid case law. We will, within different points of our reimagination efforts, turn back to the EU scenarios to evaluate the impact of the proposed solution in the mentioned repercussions/reflexes, as well as to discuss implementation related steps – believing on the more favourable conditions for an EU pioneering in pushing forward an arm's length reimagination process.

Disclaimers covered; the proposed solution encompasses different tools. Section 4.1.1. will present the outlines of the Rational Business Conduct (**"RBC"**) alternative, designed to address the (inaugural) challenges related to the arm's length *rationale* trough a more systematic implementation of light enterprise approaches to the arm's length *praxis*. Section 4.1.2. shall turn to the presentation of our Formulaic-Approach Simplification Safeguard (**"FASS"**) tools, which are responsible for the introduction of different expressions of light-formula based alternatives, both inside and in parallel with current OECD *variant's* transfer pricing methods. Finally, Section 4.1.3 shall introduce a Sequential Method Rule (**"SMR"**) to govern the iterations between our RBC and FASS, also considering current OECD *variant's* rules/elements, without which, as we will demonstrate, our reimagination efforts would be significantly undermined.

Section 4.2. will then delve into the crucial analysis of the *compatibility* issues of the proposed solution. Initially, said compatibility analysis shall look at our drawn *feasibility framework*, to then explore the more *specific* compatibility of the proposed solution with each and every element to our established arm's length core. Section 4.2. shall also evaluate the compatibility of our *reimagination* exercise with current OECD instruments and treaty network, to then conclude on the compatibility of our proposed solution with both the fundamental freedoms and the prohibition of (fiscal) State aid, in an EU scenario of application.

Section 4.3. will present the envisaged *implementation alternatives* of our proposed solution and their underlying steps. That same Section shall also turn to the reflexes of the implemented solution in the aftermath of the implementation, i.e., the prospects in terms of the arm's length/transfer pricing *disputes*.

### *4.1.1. The Rational Business Conduct (RBC) Alternative*

Our RBC alternative is a proposed mechanism to systematically introduce a light enterprise approach *rationale* to our *reimagined* arm's length *variant*, which is neither systematically addressed nor expressly mentioned in the OECD Transfer Pricing Guidelines. When presenting the outlines of the light *range* of enterprise approaches, we have characterized it by the possibility, within a transfer pricing assessment, of disregarding (i.e., not pricing) transactions (i.e., *conditions*), as long as such would be backed up by a valid commercial reason, now to be mirrored in our RBC proposal.

Our understanding is that a *condition* might be *exceptionally* disregarded in cases where both related parties *directly* benefit from the condition at stake, in cases under which, due to the *unbridged levelling*, an independent undertaking would not directly (i.e., trough the condition in itself) benefit from such, except for the monetary (or equivalent) compensation for the provision of such a *condition*/transaction – e.g., the case in the *Hornbach-Baumarkt*[591]. These conditions are *not* those which are hard to price, from a technical standpoint, as discussed under Section 3.1.4.1 above. *Mistakenly* disregarding conditions solely due to the technical difficulties in establishing prices (*terms*) would lead the RBC to be an alternative under the realm of the *hard* enterprise approaches, thus not compatible with our drawn arm's length *core*, as we have already established.

The RBC dynamics are necessary for the arm's length rationale to align with contemporary business realities and to ensure that MNEs are not *penalized* for making business in such a set-up (i.e., a *bridged* levelling[592]), undermining the underlying benefits that ultimately justify operating as a group. At the end, *not* sustaining for the application of an RBC might lead to a significant obstacle to the continuity of the globalization of the economy.

591 CJEU, *Hornbach-Baumarkt AG v. Finanzamt Landau*, *op. cit*.

592 Navarro, *op. cit*., 361.

From an EU perspective, the introduction of the RBC is a crucial measure to ensure the *proportionality* of the inherent restrictive character of the ALS, within a CJEU justification test. Our RBC, therefore, can render the ALS compliant with the *SGI* "evidence of any commercial justification"[593].

Although the RBC is not expressly mentioned in the OECD Transfer Pricing Guidelines, a couple of similar expressions, or ideas, are, nevertheless, discussed therein and must be differentiated from our proposed tool.

Firstly, the OECD Transfer Pricing Guidelines present the expression *commercially rational*, which is used in a few places within the Guidelines, but rather relates to the context of a potential disregarding of transactions (i.e., *conditions*) when such are accompanied by the artificiality of the tax avoidance schemes, made to distort the accurate delineation of the transactions[594]. Our RBC does not have this as a focus, although we have (and further will) highlight the importance of the accurate delineation of the transaction, also to our *reimagined* arm's length standard.

Secondly, the OECD Transfer Pricing Guidelines present the idea of the non-pricing of mere shareholder activities, described as "an activity which is performed by a member of an MNE group (usually the parent company or a regional holding company) solely because of its ownership interest in one or more other group members, i.e. in its capacity as shareholder"[595]. The same Guidelines go on to state that "[t]his type of activity would not be considered to be an intra-group service, and thus would not justify a charge to other group members. Instead, the costs associated with this type of activity should be borne and allocated at the level of the shareholder".[596]

We have already discussed the case of the shareholder activities when differentiating what Aitor Navarro interestingly calls (and we have adopted) *conditions* and *circumstances* established between related parties. The OECD Transfer Pricing Guidelines shareholder activities are examples of *circumstances*, which, in all cases, shall *not* be priced in a transfer pricing assessment. Our RBC refers to, as repeatedly reinstated, the exceptional *conditions*, under a *light enterprise approach* prism, which shall, in addition to the circumstances, *not* be priced.

As recognized under our Section 3.1.4.3 above, this disregarding of certain conditions would inevitably increase the *subjectivity* of the transfer pricing assessment, therefore, we propose the RBC to apply solely when the taxpayer is able to prove the merits of its usage, *en lieu* of the standard approach, which will be presented below. Naturally, we understand that the limits of these merits will be the more clearer following the gradual work of both the academia and the case law to clear the boundaries of

593 Understading the expression as Raffaele and Buriak (*Vide* Section 3.1.3.2 above) : Buriak and Petruzzi, "Transfer Pricing Rules under the ECJ's Scrutiny: Green Light for Non-Arm's Length Transactions?" *op. cit.*, 359.

594 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*, § 1.142.

595 *Ibid.*, Glossary.

596 *Ibid.*, § 7.9.

what, in practice, can be understood as fulfilling the RBC requirements.

As a conclusion, therefore, if the taxpayer meets the RBC criteria, the *condition* is *not* priced and the transfer pricing assessment ends. Contrariwise, in the majority of the cases under which *conditions* are to be priced, the *quantification* of such would have to be determined as *per* the FASS below and following the sequential rule of the SMR.

### *4.1.2. The Formulaic-Approach Simplification Safeguard (FASS) Tool*

The RBC, although *crucial* for the recognition of a *light* enterprise approach view to the arm's length standard, with all we have debated it entails, is unable to cope up with the increased subjectivity existing in the arm's length *praxis*. As such, we have already under our Section 3.1.4.3 alerted that, if implemented in isolation, a *light enterprise approach* (reflected in the RBC) could have its negative spillovers outweighing its potential benefits in terms of the arm's length *rationale*. This could be verified, as we have presented, trough an increased role of judgment calls, lack of tax and legal certainty and increased disputes around transfer pricing.

In this context, our envisaged *reimagination* solution encompasses the joint – as Section 4.1.3 below will explore – introduction of a *light formula-based* solution. This Section will, therefore, present our proposed outlines and possible design alternatives to a light FBA to the ALS, which we will later call a *FASS*.

As we have aimed at demonstrating with our considerations throughout this study, minding the contemporary business scenario (*rationale*), the challenges to the arm's length *results* have contaminated not only the operation of the standard in exceptional circumstances (i.e., *harder* cases). The *insufficiency* of the arm's length/transfer pricing methods influence (or reflect upon) the *daily praxis* of our subject matter, influencing a wide portion of *results*. This is to say, as we have already said, that our identified *randomization* issue is a product of even those – in theory – *easier* cases.

Although the analysed OECD Pillar I, Amount B seems to be in line with this understanding[597], it proposes a rather *narrow* solution, restricted to what the OECD calls "baseline marketing and distribution activities"[598]. These include, e.g., buy-sell marketing and distribution and sales agency and commissionaire transactions[599], as we have already presented within our *time* evolution assessment above.

Contrariwise, our light FBA ought to have a *broader* scope of application. In other words, it neither should be left to exceptional/*harder* cases, uncovering from the blanket a *panacea* of others, nor shall it be restricted to a segment/type of transaction (e.g., baseline marketing and distribution activities), uncovering *easier* cases related to, e.g., *manufacturing* and *services*. Our proposed solution, thus, has this statement

597 Organisation for Economic Co-operation and Development (OECD), *Consolidated Report on Amount B*, OECD Publishing, Paris, 2025.

598 *Ibid*., 6.

599 *Ibid*., § 10.

as a *premise*.

This *broad* light FBA, therefore, is to be designed to be applied *alongside* current OECD ALS *variant* methods (e.g., in the form of pre-established prices, pre-established benchmark studies' results or formula elements, to, respectively, a CUP, TNMM and a PSM). This represents, yet again, a broader solution than that proposed under Amount B, which is restricted to TNMM applicable cases[600].

Hence, our *ex-ante* elements to the ALS *praxis*, within our idea of light FBA, can be established either through a *fixed* arm's length-like approximated result/range (e.g., a fixed mark-up on costs, as in the LVAS dynamics) or through a centrally (i.e., multilaterally, bilaterally) prepared *estimation* of an arm's length-like approximated result/range (e.g., a TNMM benchmark for a certain industry). While the first retains an administratively simpler approach, the latter might enhance the verification of the *actual* compliance of the simplified approach with the ALS, thus avoiding blurred lines with a *harder* version of an FBA – which is *not* welcomed.

As with Amount B and, in fact, as a reflex of the *time* evolution assessment conclusion of a wider applicability of the TNMM (i.e., transactional method) in face of the CUP (i.e., traditional method), our light FBA is *preferably* applied within a TNMM set-up. This entails that it *shall be* applied as long as, in a current OECD's *variant* assessment, the conditions of application of a TNMM are present, as discussed, e.g., under paragraphs 2.65-2.67 of the OECD Transfer Pricing Guidelines[601].

Differently than Amount B[602], while acknowledging that there may be instances in which the application of the CUP *might* also be deemed applicable (and, arguably/in theory more appropriate), our TNMM FBA shall still prevail, as a strengthened guarantor of the needed *objective* and *verifiable* criteria in the ALS *praxis* (tax and legal certainty), unless the parties to the transactions are in jurisdictions which have adopted, for the object of the transaction, a bilateral/multilateral CUP FBA (i.e., a determined price for the specific good)[603]. Although Amount B presents the possibility of this CUP *exit* as rather exceptional[604], it can potentially be much more explored under our broader scope of application of a *light* FBA (e.g., encompassing transactions with commodities).

A second exit to the *standard* TNMM FBA would then be based on the non-routine functional profile of the tested party, allowing for the application of a PSM instead. When the PSM *exit* apply, the transaction shall be priced under *either* the application of current PSM OECD *variant or*, if agreed between the jurisdictions involved, by an FBA PSM. The design of an FBA PSM is, certainly, more administratively complex, but can draw inspiration from the approaches presented in the early stages of the time

600 OECD, *Consolidated Report on Amount B*, *op. cit.*, § 41.

601 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*, § 2.65-2.67.

602 OECD, *Consolidated Report on Amount B*, *op. cit.*, § 42.

603 Which could be potentially interesting/relevant in case of *commodities*.

604 OECD, *Consolidated Report on Amount B*, *op. cit.*, § 42.

evolution of the ALS, as in Four Economists Report[605] and the Carroll Report[606] - *nothing new under the sun*.

In parallel with the first (the Four Economists Report), our FBA PSM could resemble the *division of tax* method, under which, as we have explained, possible principles criteria/formula can be the value of sales, capital employed, real estate or property values maintained, wages and salaries paid, and credits and stocks maintained within each jurisdiction[607].

As in connection with the Carroll Report, our FBA PSM could resemble the *fractional apportionment* method (e.g., as applied by certain jurisdictions/US states), under which elements to the formula can be based on factors like sales, payroll, and property[608]. Although Carroll had expressly demonstrated concern on the *arbitrariness* of this method (and with the use of formulas, in general)[609], due to its *oversimplification*, we must interpret the author's position considering *current* arm's length evolution reality. As we have discussed above, we do not see that (*light*) FBA would bring a level of *arbitrariness* to the ALS *praxis*, especially within the PSM realm, which would be *higher* than current arbitrariness emerging from the *random* results produced. Even if a similar level of arbitrariness would to be argued, better a simpler one than an over complex other[610].

Adding specific *weights* to the formulas' elements based on e.g., the different industries/types of transaction might be an interesting compromise between the *objective* and *verifiable* criteria and the *actual* intent to mimic an arm's length-like result, reducing what Carroll once called the *oversimplification*[611], given the yet further subjectivity around the uniqueness of the contributions underlying a PSM application/*exit*.

If no *exits* apply (i.e., CUP or PSM), the TNMM FBA then kicks in. Section 4.1.3. will further explore the *sequential* rule leading to such potential application.

It is important to note that, under our proposal, this simplification approach shall *not* be optional, although the RBC exemptions, as presented below, shall apply if its merits are sustained by the taxpayers. This *juris tantum* character of application, therefore, justifies the term *safeguard* (as found in *FASS*), terminology which we will now start to more systematically use in this study. In other words, if the jurisdictions involved have agreed on the introduction of a FASS, the application of such shall not be

605 League of Nations. *Report on Double Taxation Submitted to the Financial Committee*. *op. cit*.

606 Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, *op. cit*.

607 League of Nations. *Report on Double Taxation Submitted to the Financial Committee*. *op. cit*.

608 Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, *op. cit*.

609 *Ibid*., as discussed by the same author in Carroll, "International Tax Law: Benefits for American Investors and Enterprises Abroad", *op. cit*., 705.

610 A very similar mindset is present in current choice of transfer pricing method under the US BMR, *vide*: United States Treasury Department, *Treasury Regulations on Income Tax: Section 1.482-1 (1994),* 2, c.

611 Carroll, "International Tax Law: Benefits for American Investors and Enterprises Abroad", *op. cit*., 705.

elective, differently than with proposed Amount B, and taxpayers and tax authorities alike shall be bound to it[612].

Our TNMM FASS shall result in an *immediate* solution to four out of the five main TNMM issues we have identified under Table 1 above[613].

Initially, and inspired by Amount B[614], the TNMM FASS *must* provide for rules on how to adequately account for the cost-base to which the respective profit level indicator (**"PLI"**) shall apply. This would result on a streamlined choice of cost-base, thus eliminating or, at least, significantly attenuating, the challenge under the second column of Table 1, i.e. on the adequate choice of cost-base to the TNMM application.

Secondly, the adoption of the TNMM FASS shall be capable of significantly reducing the issues around the reliable information on potential comparable, read as the practical challenges to the *in casu* benchmark comparable selection (i.e., search *strategy* determination), leading to so many disputes, as demonstrated above. At most, disagreements could arise in terms of the multilaterally (or bilaterally) produced central benchmark, in cases it applies, but this would not be mirrored in the current *panacea* of *in casu* disputes. Individual (i.e., in *casu*) benchmarks can still exist, although their roles would be reduced to serve as a mere business guidance for taxpayers, but no longer for a *direct* tax purpose (as an ALS/transfer pricing consequence).

Thirdly, Table 1 challenges on the adjustments to the comparability analysis shall also be significantly mitigated. In current *praxis*, as also illustrated by our case law analysis made above, adjustments to the application of the TNMM are often extremely subjective and object of disagreements, rarely supporting an *actual* improvement of the comparability exercise. A TNMM FASS shall, therefore, contain *objective* and *restricted* options for adjustments. The idea is to ensure the prevalence of tax and legal certainty (*objective* and *verifiable* criteria) over *uncertain* (in many cases, as just stated, arguably *uncapable*) adjustments.

A valid idea could be the possibility to expand the standard range or use a certain portion of the range[615] in case certain triggers (to adjustments) are verified – again, due care must be taken not to significantly impair the objectiveness of the TNMM FASS.

Finally, the TNMM FASS must also encompass instruments to avoid disruptions by an anachronic application of results in face of changing economic cycles. As such, formulaic (*ex-ante*) elements to its application must be periodically reviewed and mechanisms shall be in place as to trigger additional updates in case of particularly relevant economic circumstances, be them general (e.g., COVID, the War in Ukraine, etc.), be them industry-specific (e.g., shortage of raw materials, significant increase in services demand, etc.), although we recognize that such updates might be challenging,

612 Below, we will turn to the implications of this non-elective system in case one of the jurisdictions which is a party to the transaction *does not* adopt the FASS.

613 *Vide* Section 3.2.1.2.

614 OECD, *Consolidated Report on Amount B*, *op. cit*.

615 Ranges which, in current Amount B proposal, are quite narrow, *see*: OECD, *Consolidated Report on Amount B*, *op. cit*., e.g., § 44 ff.

especially for the more specific ones.

In any case, although difficulties in efficiently triggering updates might undermine the efficiency of the TNMM FASS and its actual capabilities of mimicking an actual arm's length-like result for the analysed period, we do not see it as leading to a significantly worse-off situation than current *multi-year*, *in-casu*, OECD approach to the TNMM application[616]. As we will further discuss in the implementation Section below, a multilateral (or even *regional*, i.e., EU-wide) implementation of the FASS could be very helpful in addressing this difficulty.

The introduction of a TNMM FASS, nevertheless, would still *not* be able to tackle the first issue we have identified under Table 1 – the determination of the functional profile of the tested party. The difference is that, as the SMR below will present in a more structured way, the issue would be moved from the choice of method (i.e., TNMM *vs*. PSM) under an OECD MAM and would rather be shown in whether the taxpayer shall take the PSM *exit* within our FASS dynamic. Recognizably, it is the same problem, just placed at a different moment of a transfer pricing method application.

Additionally, this issue can be mirrored in the understanding of which pre-determined result to benchmark the analysed transaction against, when and if such result is determined by industry/transaction grouping (similarly as proposed under Amount B).

In any case, and in alignment with our reimagination goal, the FASS TNMM would *not* lead to a worse-off position in terms of the difficulty in understanding the functional profile of the tested party and the OECD efforts on the accurate delineation of the transaction must be dully applied, as prescribed by current OECD Transfer Pricing Guidelines[617]. *Some* level of subjectivity will always exist in the application of the ALS, as with virtually everything in the legal field.

The (*optionally implementable*) PSM FASS (*exit*) is also expected to attenuate the negative effects of the challenges to current PSM, as presented in this study, namely the determination of the elements responsible for the profit split and for the weight of each of these. Likewise the standard TNMM FASS, the PSM FASS (*exit*) is not expected to solve the challenge/issue of the determination of the functional profile of the parties, but in our proposed solution design, this will be a *prior* issue to the PSM FASS (*exit*) in itself, as a taxpayer shall only be entitled to a PSM FASS (*exit*) at the first place when such a functional profile was, previously, deemed in line with the application of this method.

We recognize, nevertheless, that the FASS should not *fully* replace current OECD approaches. Therefore, two sets of situations, i.e., financial transactions[618] and those

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616 Broadly framed, under the instrument's discussions of the comparability analysis: OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit*., § 3.75 ff.

617 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit*., e.g., § 1.35.

618 Please refer to the examples under Section 3.1.4.1 above.

which an economic valuation is deemed the most adequate testing approach[619], are initially presented as *carve-outs*, leading to a subsequent transfer pricing assessment just as currently carried-out, under the OECD rules. Although not recommended, as supplementary carve-outs can undermine the efficiency of the FASS, additional situations can be included in the cut, which can also be done as part of a phased/progressive implementation of the FASS under a specific scenario.

Note, nevertheless, that these are carve-outs to the application of the FASS, *not* the RBC. In case the interested party/taxpayer sustain the application of a RBC, the latter should lead to a not-priced condition, regardless of any potential future testing as a financial transaction or based on an economic valuation.

As we will discuss within both our *compatibility* (Section 4.2) and *implementation* analysis (Section 4.3.), our *light* FBA is not, in itself, strange to current OECD *variant* and can be readily implemented in the ALS *praxis*.

### *4.1.3. The Sequential Method Rule (SMR)*

The existence of new elements (and their *iterations*) within our reimagined arm's length/transfer pricing *praxis* inevitably calls for a need to also reimagine the rules governing their *application* (and, again, their *iterations*). Although neither the US BMR[620], nor the OECD MAM[621] are deemed to be enough/appropriate to govern such application/iterations, our proposed SMR shall seek inspiration in both the BMR and the MAM.

Initially, and differently than its predecessors, our SMR should contain a *clear preference towards one of the methods* – our standard (*safeguard*) TNMM FASS. This is a recognition not only of the practical prevalence of the TNMM, although in its current OECD *variant's* form, as the most applied transfer pricing method[622], but also, of the foreseen benefits the introduction of formulas – through the TNMM setup – can bring to the arm's length challenges we have discussed. This method's preference (translated in the idea of a *safeguard*) also substantiates our idea that the TNMM FASS, provided no exceptions to it apply, shall *not* be optional for taxpayers and tax authorities, once implemented by the relevant jurisdiction.

The Figure below illustrates the preference of the SMR for our TNMM FASS and systematizes the hypothesis of application of other methods (or the RBC *exit*). The application of each possible alternative method to the TNMM FASS shall be applied in accordance with a specific *sequence*, which not only provides for strengthened legal

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619 Please refer to the examples under Section 3.1.4.1 above. Note that, for the cases with economic valuations, to minimize the application of the carve-outs, whenever a TNMM is also applicable (i.e., royalties), priority shall be given to said (FASS) TNMM instead of the economic valuation approach.

620 United States Treasury Department, *Treasury Regulations on Income Tax: Section 1.482-1 (1994).* 2, c.

621 OECD. *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 1995. *op. cit.*, § 2.2.

622 As we have discussed, e.g., under Section 2.1.6.

and tax certainty, but also significantly lessen administrative burden when compared to the (more subjective) justification of the choice of an *adequate* method.

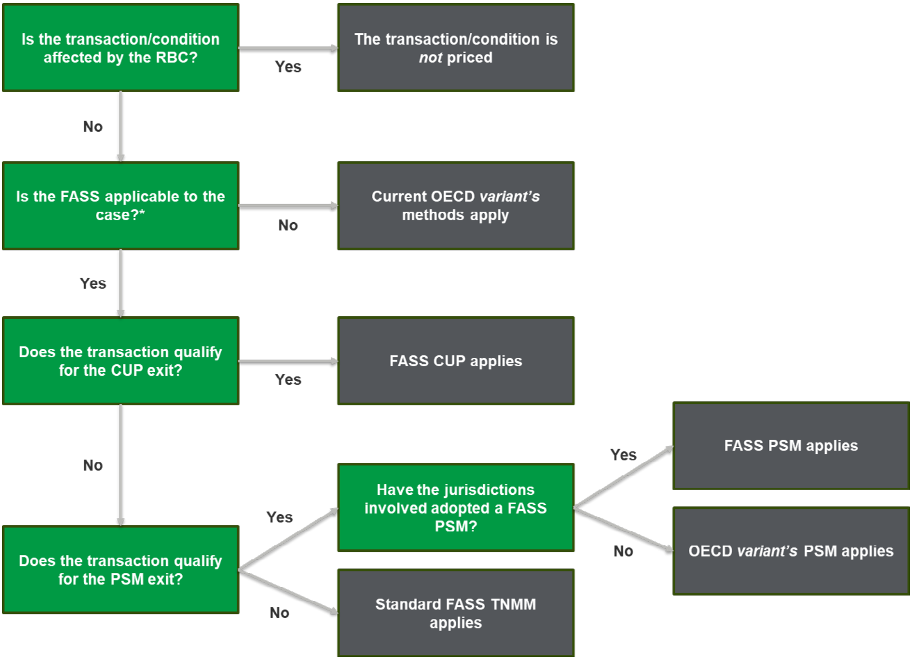


**Figure 4. The SMR detailed stap-plan**

**Incl. analysis on the applicability of the FASS carve-outs.*

As a final clarification, it is important to note that the SMR is not, even within an RBC exit situation, a MAM. In such case, when the FASS is not to be applied due to an RBC exit, we are in face of *condition* that must *not* be priced, even though it would typically be in an independent party setting. Therefore, the taxpayer would *not* resort to the application of another, i.e., supposedly more appropriate, pricing method, but would rather proceed to a *non-pricing* scenario, as we have already discussed.

## 4.2. Compatibility Analysis

As stated right from the introduction to this study, a compatibility analysis/test of a proposed solution (i.e., reimagination exercise) is crucially important. The sections below will, therefore, advocate for both a legal (i.e., theoretical) and political (practical) compatibility of our reimagined ALS with i. the *feasibility framework* (Section 4.2.1), ii. the core of the arm's length standard and its constituent elements (Section 4.2.2), iii. the OECD's arm's length variant and the Organization's implementation documents (Section 4.2.3), and, finally, iv. the EU Law, its fundamental freedoms and the prohibition of (fiscal) State aid.

### *4.2.1. Compatibility of the Proposed Solution with the 'Feasibility Framework'*

We have described the feasibility framework as prescribing that any solution, which ought to be implementable, to the contemporary challenges undermining an efficient global taxation of the profits obtained by MNEs' constituent units (minding their *allocation*) shall not escape the realm if corporate income taxes. Our proposed solution is not radical and, as its terminology (*reimagination*) suggests, does not go beyond that tax object and, without the need for further considerations, does not fall outside of the feasibility framework at least, for now, from this inaugural prism.

Secondly, we have also advocated for the fact that no supra-national (corporate income) taxes would possibly be accommodated within a feasibility framework. Through this additional lens, our reimagined ALS *does* comply with the established feasibility framework. Note that steps towards enhanced/strengthened coordination, as we have presented above, cannot (and *shall not*) be misunderstood to mean the creation of a single/supra-national tax.

This would not even be the case – now already extrapolating the terms of our proposal – with a (*super*) *hard* formula-based alternative, be it a tax base consolidation mechanism/formula (e.g., the proposed CCCTB in the EU[623]), be it with some forms of unitary taxation as, even in face of those, taxes would still remain (be levied) domestic(ally).

Last but by no means least, the feasibility framework commands that a proposed solution must be in line with *a* notion of arm's length, imposing a limit to *openly* at *non*-arm's length propositions. It goes without saying that a reimagined arm's length standard does not contradicts this command. Naturally, a corollary of this third point is the need to evaluate whether said propagated as *at* arm's length solution indeed as such is. This effort test must, therefore, take into account the analysis of the compatibility of the proposed solution with the different elements of our drawn ALS *core*, an endeavour undertaken in the Section below.

For now, we conclude on the *undoubtful compatibility* of our reimagined arm's length standard with the established feasibility framework.

### *4.2.2. Compatibility with the Arm's Length Core*

A harder, rather *more complex*, exercise is to analyse the compatibility of our reimagined ALS with the five different elements that, according to our study, constitute the *core* of the arm's length standard. Failure to pass this analysis/test would lead to undesired spillovers in our previous compatibility assessment (i.e., with the third point of our drawn feasibility framework) and would significantly undermine a satisfactory practical adoption/implementation of our proposed solution.

623 *Vide* Section 2.1.10.1. EC, *Proposal for a Council Directive on a Common Consolidated Corporate Tax Base*, *op. cit.*

#### *4.2.2.1. Rationale*

The analysis starts, therefore, with the confrontation of our reimagined ALS and our established *rationale core* element, as described under Section 2.2.1 above.

Accordingly, the *rationale* of the ALS lies in ensuring that financial or commercial conditions established between associated parties are those which would have been made between independent parties under similar circumstances, safeguarding a faithful individual ability-to-pay assessment of each of the MNE's constituent units. Under the same Section 2.2.1, further explored in this study, we have established that this is not to say that all intra-group *conditions* are to be priced, under the application of the ALS, as this could potentially lead not to the actual observance of the individual ability-to-pay principle, but might actually lead to a distortion of said principle in certain cases. A corollary to this understanding is the conclusion that a light enterprise approach-based *rationale* is *not* contrary to the ALS core.

Our proposed solution, adopting a light enterprise view/*rationale*, as reflected and discussed within our RBC is, therefore, aligned with the ALS *rationale core*, thus passing the first fifth of our currently undertaken test.

#### *4.2.2.2. Results*

As a second part of the ALS *core* compatibility assessment, our proposed solution's *results logic* must be in line with the boundaries established by our Section 2.2.2 above. Therein, we have concluded that a traditional (as we have called) view on the strict comparability requirements is not necessary for a determined result to be compatible with the ALS, sufficing a broader understanding of comparability, as seeing in many different occasions along the *time* evolution assessment of the arm's length standard. On the tail of these considerations, Section 3.1.4.1 established that nothing in the core of the ALS is, therefore, contrary to results obtained by the application of *light* formula-based alternatives. A similar conclusion was reached, in regards of *light* formula-based solutions, in terms of the approximate nature of the arm's length *result's* core.

In fact, the same *time* evolution assessment has also shown that formulas have been proposed (and adopted) since the beginning of our *journey*, as already exemplified in the *Caroll Report*[624]. Our FASS, targeted to tackle the challenges inflicting the arm's length *result's* core is to be considered as an expression of the *light*-FBA, as thoroughly discussed under Section 4.1.2 above, and, hence, is compatible to the arm's length *result's* core, leaving only three further assessments to the compatibility test to be further discussed.

624 Carroll, *Taxation of Foreign and National Enterprises: A Study of the Tax Systems and the Methods of Allocation of the Profits of Enterprises Operating in More Than One Country*, *op. cit.*

#### *4.2.2.3. Compliance Requirements*

As we have stated under Section 2.2.3 above, the *compliance requirements'* core of the ALS is intrinsically related to the ALS results (herein, under our proposal, significantly impacted by the FASS) as the more adequately the latter is structured (i.e., arrived at), the easier it shall be for the former to fulfil the requirement of demonstrating the arm's length nature of the transactions under auspices. An overly complex/burdensome ALS might, paradoxically, fail to demonstrate, within its *formal* compliance requirements, its own arm's length compatible nature.

Our FASS, as the central element to our reimagined ALS, shall provide for a significantly increased simplicity in the ALS assessment, which would be translated into a lower (*undue*) administrative compliance constrain/burden to taxpayers, leading to a more (objectively) verifiable ALS *praxis*, prone to increased tax and legal certainty. As such, our reimagined ALS is clearly compatible with Section's 2.2.3 established arm's length compliance requirements' core.

#### *4.2.2.4. Roles*

Our proposed changes to the arm's length standard were designed precisely to tackle its perceived inefficiencies and, as such, to ensure the fulfilment of the standard's necessary roles as both an allocation and an anti-avoidance mechanism, as we have stated under Sections 2.2.4.1 and 2.2.4.2., respectively. In that regard, and likewise our conclusions above, not only our reimagined ALS presented under this Chapter 4 has those same roles as a target, but it is also, as we advocate, significantly more capable of fulfilling in reality/practice the arm's length roles. This leads to the conclusion on the compatibility of our reimagined ALS with the standard's *core*.

#### *4.2.2.5. Coordination*

As already discussed, we do not believe on an immediate joint/uniform application of an ALS reimagination set of measures in a way that "all find acceptable and that avoids both double-taxation and partial or full non-taxation"[625], especially if looking at a beyond-EU prospect of implementation.

Differently is to say, as Avi-Yonah, Clausing and Durst that this might not be a desirable objective, within a logic that, once implemented by one jurisdiction (or by the EU, as we foresee), others would tend to follow[626]. This aligns with our semi-coor-

625 J. Clifton Fleming Jr., Robert J. Peroni and Stephen E. Shay. "Is Unilateral Formulary Apportionment Better than the Status Quo?" *in The Allocation of Multinational Business Income: Reassessing the Formulary Apportionment Option*. Ed. Richard Krever and François Vaillancourt. Series on International Taxation, v.76. Wolters Kluwer. 2020: 172.

626 Reuven S. Avi-Yonah, Kimberly A. Clausing, and Michael C. Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split," *Florida Tax Review* 9, no. 5 (2009), 508-510.

dinated view of the ALS' core, without impairing a currently unfeasible – yet *desirable* – adoption of a more coordinated/globally uniform measure in the future. In other and simpler words, it is good to have a higher degree of coordination, while it is not essential to wait for it[627].

The question which remains open (although not changing our conclusions within this Section) is, nevertheless, which operator (i.e., jurisdiction or region), firstly introducing the measures, would be able to *pioneer* its global implementation. Given our already mentioned EU 'advantages', we believe this could be something favouring the region, although it is yet to be seen how this could be pushed forward without, e.g., the US support. Upcoming discussions on the continuation of OECD Pillar II, without the US' participation could anticipate answers to our open questions.

In a nutshell, nevertheless, it is clear that our proposed reimagination of the ALS is deemed *compatible* with the identified ALS *coordination* core and that a uniform global application, although desirable, is *not* essential for the passing of this compatibility test.

### *4.2.3. Compatibility with the OECD Arm's Length Standard and its Instruments*

Notoriously, the efforts undertaken within this study lie in proposing changes to the *current* OECD ALS *variant*. As such, a full compatibility between our reimagined arm's length standard and the latter is not only not achieved, but teleologically not possible. What we aim to evaluate herein, and after having before sustained the practical importance of the OECD operationalization instruments, is whether our reimagined ALS is compatible with such *instruments*, namely the OECD Model Tax Convention[628] and the OECD Transfer Pricing Guidelines[629]. Given their fundamental importance as a forum (i.e., basis) for an expeditious implementation of changes to the ALS[630], this compatibility exercise is *a must*.

As presented within our *time* evolution assessment, the *authoritative statement* of the arm's length standard in contemporary (and for a long time back), lies in the wording of Art. 9 of the OECD Model Tax Convention, as collated, in its paragraph 1, below:

627 This also summarizes the thoughts of Avi-Yonah, Clausing and Durst, cited above, when the authors proposed the introduction, back in 2009, of formulary apportionment in the US international tax law policy, *see*: Reuven S. Avi-Yonah, Kimberly A. Clausing, and Michael C. Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split," *Florida Tax Review* 9, no. 5 (2009), 508-510.

628 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017. op. cit.*

629 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022. op. cit.*

630 As multiple times demonstrated by the ALS *time* evolution assessment.

"Where

a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."[631]

Our proposed solution, fitting within our drawn arm's length core and being the above Art. 9, as we advocate, an oversimplification of the former, is also compatible with current Art. 9 and, therefore, with the structure and the dictates of the double-tax treaties[632] (in majority based on the OECD Model Tax Convention[633]). An important point to consider is, nevertheless and as with all the articles of the OECD Model Tax Convention, the official *commentaries* to it[634] and the compatibility of our proposed solution with them, despite their theoretical softer law nature. Firstly, the commentaries highlight the importance of the OECD Transfer Pricing Guidelines[635], stretching the importance (need) for our compatibility analysis to encompass this second OECD instrument, as we will shortly turn to in this Section. Secondly, although our reimagined ALS seems fully in line with the commentaries (i.e., no fundamental changes being required in the wording of the latter), depending on the level of implementation of our proposed solutions, controversies around the corresponding adjustments (Art. 9.2[636]) thoroughly discussed in the commentaries, would be lesser needed, due to a higher level of coordination nature among the different ALS variants. Section 4.3.1 below will further explore this point.

Finally, as stated, the compatibility between our proposed solution and the OECD Transfer Pricing Guidelines must be assessed.

631 OECD, OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017. op. cit.*, Art. 9.1.

632 Although not addressed in this study, the arm's length standard is also showcased as part of the double-treaty network to authoritative statements found in other model tax conventions, such as the UN Model, *see*: United Nations (UN). *United Nations Model Double Taxation Convention between Developed and Developing Countries*. New Yok: United Nations, 2021, Art. 9. As these authoritative statements are *oversimplifcations*, we do not see our compatiiblity assessment, herein made in regards to the OECD Model Tax Convention would be significantly different if established between other model conventions, e.g., the UN Model.

633 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017. op. cit.*

634 *Ibid.*, Commentaries.

635 OECD, *Model Tax Convention on Income and on Capital: Condensed Version 2017. op. cit.*, C(9) – 1.

636 *Ibid.*, Art. 9.2.

As discussed within both our *time* evolution and increased coordination sections of this study, the OECD Transfer Pricing Guidelines (since 1979[637]) has both embodied and *propelled* the main changes to the ALS dynamics or, if one will, for the *reimagination* steps taken ever since. We do not fall short on examples, which can be pointed out in the 1995 update, with the landmark introduction of the transactional transfer pricing methods[638] or, in 2017, with our labelled *light*-FBA LVAS introduction[639], beyond many other items such as specific chapters for business restructurings and financial transactions, etc[640].

Despite its soft law character, the OECD Transfer Pricing Guidelines is a crucial instrument for the introduction and implementation of changes to the ALS, given its profound influence in the design and operationalization of the various ALS variants around the world, including for those originated in domestic systems of non-OECD jurisdictions – which more than justifies the relevance of our compatibility assessment.

Turning to the nucleus of the matter, our *reimagined* ALS is, in many aspects, *divergent* from that of the OECD, which inevitably means divergent to some of the points contained in the OECD Transfer Pricing Guidelines, as, e.g., in terms of the MAM (against our SMR) and the added FASS layer, inexistent in the OECD instrument. Nevertheless, we strongly believe in the capacity of the latter to accommodate our prescribed changes, given the flexibility that history has shown it embraces and the benefits we have demonstrated can arise from this accommodation. As such, although currently divergent in some points, we advocate for the compatibility of our proposed changes with the OECD instrument, given that a new update is released. Our Section 4.3. will delve into the details of these updates and their different options.

### *4.2.4. Compatibility with the EU Law*

Our proposed solution's compatibility with EU Law must be analysed, given our particular interest and side emphasis on the reflexes of both the challenges and, as Section 4.3. will further explore, of the solutions to the former, in an EU context. This compatibility exercise is also justified by our belief that, once compatible, a reimagined ALS can be pioneering put forward by the EU, as we have already raised.

This compatibility analysis will be divided into *two* specific assessments, based on i. the *fundamental freedoms* and, ii. on the *EU prohibition of (fiscal) State aid*. This structure not only follows the structure we have generally adopted under our Chapter

637 *Vide* Section 2.1.4. OECD, *Transfer Pricing and Multinational Enterprises*, *op. cit*.

638 *Vide* Section 2.1.5. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, 1995. *op. cit*.

639 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*. *op. cit*., § 7.43 ff.

640 Currently reflected in, respectively, Chapters IX and X of the current version of the OECD Transfer Pricing Guidelines. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022*. *op. cit*.

3, when presenting the reflexes of the arm's length elements core's challenges in the EU but also aims at covering the two areas based on which we have advocated for the incompatibility of current OECD ALS *variant* with EU Law. If our *reimagined* ALS, thus, passes the compatibility tests under the Sections below, not only its implementation would be feasible in the EU but, even more importantly, it would imply that it is *more fit* for the EU than its current OECD pair.

#### *4.2.4.1. The EU Fundamental Freedoms*

It is impossible not to start this Section with an *ipsis litteris* reminder of the compatibility criteria with EU Law (actually, *justification* of a restriction to the EU fundamental freedoms), brought under our repeatedly cited paragraph 71 of *SGI*:

> "National legislation which provides for a consideration of **objective and verifiable elements** in order to determine whether a transaction represents an artificial arrangement, entered into for tax reasons, is to be regarded as not going beyond what is necessary to **attain the objectives relating to the need to maintain the balanced allocation of the power to tax between the Member States and to prevent tax avoidance** where, first, on each occasion on which there is a suspicion that a transaction goes beyond what the companies concerned would have agreed under fully competitive conditions, the taxpayer is given an opportunity, **without being subject to undue administrative constraints**, to provide **evidence of any commercial justification** that there may have been for that transaction."[641] (*Our highlights*)

Throughout our Chapter 3, we have demonstrated that, in relation to different elements of the arm's length core, all those herein highlighted requirements of *SGI* were actually not currently observed – thus our conclusion, reinstated above, that the contemporary OECD ALS *variant* is not compatible with the EU Law. Our proposed solution, nevertheless, addresses all the above points.

The requirement for *objective and verifiable criteria*[642] is set under our proposed FASS dynamic ; the possibility of provision of *evidence of any commercial justification*[643] is unlocked by our systematic introduction of the RBC, while the reduction of the *undue administrative constrains*[644] is *directly* tackled by the implementation of our SMR and is an *indirect* consequence of both the FASS (as a simplification tool) and, finally, through a more efficient standard, the justifications' objectives of maintaining a *balanced allocation of the power to tax* between the Member States and of *preventing tax avoidance*[645] can actually be achieved.

641 CJEU, *Société de Gestion Industrielle v. Etat belge*, *op. cit.*, §71.

642 *Ibid.*, §71.

643 *Ibid.*

644 *Ibid.*

645 *Ibid.*

This leads us to the conclusion that our *reimagined* ALS is complaint with and necessary to the EU Law.

### *4.2.4.2. The EU Prohibition of (Fiscal) State Aid*

The EU prohibition of (fiscal) State aid, enshrined under Art. 107 (1), TFEU[646], have been increasingly infringed, and, thus, increasingly contributed to the aggravation of some of the challenges we have presented under Chapter 3, by the adoption, by Member States, of *ex-post* increased coordination measures, namely, here, the APAs discussed in the EC investigation in, e.g., *Starbucks*[647], *Fiat*[648], *Apple*[649] and *Amazon*[650].

The possibility of the granting of (*fiscal*) selective advantages, under APAs, shall always be deemed real, if such a measure exists. In that sense, our reimagined ALS does not completely eliminate the possibility of APAs but, although recognizing its importance in certain instances, will propose to reduce its application to rather *residual* cases (based on Section 3.5.3.1 above and as detailed under our implementation considerations below). Less space for APAs shall be translated into less cases of fiscal State aid and, as such, the compatibility of our ALS with this prism of the EU Law shall be understood as likely.

Naturally, depending on the outsets of implementation, our *reimagined* arm's length standard might still create incompatibilities with the EU prohibition of (fiscal) State aid. This would be the case of an initial, *partial*, implementation by certain Member States of measures such as our FASS solely to some (*selective*) taxpayers, in detriment of others. This will *not* be the prescribed implementation route of our proposed solution and, therefore, it shall not, in practice, lead to issues as such. More on that is to be presented under Section 4.3 below.

## 4.3. Implementation Steps

### *4.3.1. Levels of Implementation (Ex-Ante Increased Coordination)*

Minding the necessary semi-coordinated nature of the arm's length standard[651], as stipulated above, the implementation steps to our proposed solution, within a

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646 EU, *Consolidated Version of the Treaty on the Functioning of the European Union*, *op. cit*., Art. 107(1).

647 EC, *Commission Decision (EU) 2017/502 of 21 October 2015 on State Aid SA.38374 (2014/C ex 2014/NN) Implemented by the Netherlands to Starbucks*. *op. cit*.

648 EC, *Commission Decision (EU) 2016/2326 of 21 October 2015 on State Aid SA.38375 (2014/C ex 2014/NN) Implemented by Luxembourg to Fiat*. *op. cit*.

649 EC, *Commission Decision (EU) 2017/1283 of 30 August 2016 on State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) Implemented by Ireland to Apple*. *op. cit*.

650 EC, *Commission Decision (EU) 2018/859 of 4 October 2017 on State Aid SA.38944 (2014/C) (ex 2014/NN) Implemented by Luxembourg to Amazon*, *op. cit*.

651 And despite the (currently unfeasible) goal of *full* coordination. *Vide* Section 2.2.5.3 above.

reimagination logic, must exclude any unilateral measure/ground of implementation. Additionally, as we will further explore, still within a semi-coordination kind of nature, different levels (or steps towards a *full* coordination) exist, that is why we have also presented several measures/instruments/forums of increased (semi) coordination. It is precisely this multitude of potential levels of (semi) coordination that gives rise to different possible ways (or levels) of implementation of our proposed changes to the ALS, still compatible with the points we have raised under Section 4.2. above.

Sections 4.3.1.1 to 4.3.1.3 below will, therefore, present different potential levels of implementation of our reimagined ALS, understanding that these might not, necessarily, exhaust all the possibilities. Section 4.3.2. and followings will confront these potential levels of implementation with iterations (with different ALS *variants*, if applicable) and underlying disputes prospects. The focus of the implementation of our reimagined ALS, as should already be clear to our reader, is on what we have previously called *ex-ante* measures (or solutions). Section 4.3.3. will, nevertheless, present how we foresee the iteration of those with *ex-post* solutions, which shall carry a residual role in the ALS *praxis*.

#### *4.3.1.1. Multilateral Implementation*

A multilateral level of implementation would, *theoretically*, be the most desirable level of implementation of our proposed solution, it would, *in theory*, represent the furthest step towards an idealized *full* coordination nature of the arm's length standard. Please note, nevertheless, that even within a multilateral level, several are the actual degrees of implementation and the actual extent of assimilation of the reimagined ALS by the different jurisdictions in the international community. A multilateral implementation does *not* necessarily mean a *global* implementation.

Here, the international community could make use of the MLI[652], despite criticisms to its efficacy[653]. A *higher* level of multilateral implementation could depart e.g. from the inclusion of the new proposed solutions as additional minimum standards to the MLI, possibly referring to annexes thereto or, minding consistency and updates viability, making binding references to the OECD Transfer Pricing Guidelines, where the proposed solutions would be introduced, and/or to annexes thereof. Naturally, the political constrains to that *higher* level of multilateral implementation are significant, especially in light of the already limited success of the MLI in a broad international tax law perspective. In addition, note that this higher level of multilateralism is also *not global*, as not all the jurisdictions are signatories to the MLI, hence, still no *full* coordination under this design.

652 Organisation for Economic Co-operation and Development (OECD). *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, op. cit*.

653 *Vide* Section 2.1.7. above. *See*, e.g.: Hattingh, "The Multilateral Instrument from a Legal Perspective: What May Be the Challenges?", *op.cit*.; Hattingh, "The Impact of the BEPS Multilateral Instrument on International Tax Policies,", *op.cit* and Berbari, *op.cit*.

A *shorter* step in terms of the level of multilateral implementation but, similarly affected by some political constrains, would be a solution under which, despite similar technical outlines as presented in the paragraph above, would *not* be included as a minimum standard to the MLI. Here, our thought is that this would ultimately bridge the gap between this and the *bilateral* levels we will explore under Section 4.3.1.3 below.

As the Four Economists Report and the Carroll Report have long perceived, multilateralism is not easily found or managed in matters of direct taxation in an international setting. Not disagreeing with these, we see (and have demonstrated within our *time* evolution assessment) an increased tendency towards an at least *tacit* multilateralism, including a strengthened role of both the OECD Model Tax Convention and the OECD Transfer Pricing Guidelines and, as such, even bilateral levels of implementation can *drink* from multilateral efforts. The influences of the mentioned instruments (as expressions of multilateral efforts) in the bilateral levels of implementation will be discussed under Section 4.3.1.3 below.

#### *4.3.1.2. Regional (EU) Implementation*

An EU-wide implementation of our reimagined ALS is also a (*specific*) form of *multilateralism*. As we have previously advocated in favour of, the EU presents specific instruments (*scenarios*) for a more politically viable pioneering in a *multilateral* introduction of our proposed solution when compared to, e.g., the MLI in a general international outset – an EU *minimum standard*, possibly under the auspices of an adjusted Transfer Pricing Directive Proposal[654]. This study also did not fall short in highlighting the pressing reflexes of the general ALS challenges in the EU, thus corroborating that an understanding of the *current* OECD-based ALS *variants* as non-compatible with EU Law would make the EU-wide multilateralism implementation politically viable and *desired*, as the recent EC Transfer Pricing Directive Proposal and the overall context of the EC efforts corroborate.

As such, beyond the recommendations we find under Petruzzi and Argyro's paper e.g., a better alignment in *wording* and, overall, *setting*, between the EU and the OECD instruments[655], we also see the need for the Transfer Pricing Directive Proposal to include the elements to our RBC, FASS and SMR. Here, a first option would be for the Transfer Pricing Directive Proposal to establish the underlying *technical* design elements, e.g., the *formulas* to be used and the governing of the FASS *exits*, as presented under our Section 4.1.2. A potential problem with this apparently increased coordination step is that EU Member States would be constrained to use such technical design elements in their relations with third countries, which might create an additional challenge in terms compatibility with existing bilateral treaties. To cope up with this

654 EC, *Proposal for a Council Directive on Transfer Pricing Rules and on a Common Framework for Transfer Pricing in the European Union*, *op. cit*.

655 Petruzzi and Myzithra, *op. cit*., 24-25.

issue, the Transfer Pricing Directive Proposal can determine that the application of the specific *technical* design elements to be a *safeguard*, i.e., applied in case the specific Member State does not hold a bilateral agreement with the other interested party prescribing different technical elements.

In failing to address these items, the Transfer Pricing Directive Proposal risks creating further coexisting ALS *space variants*, undermining the idea of an EU effective minimum standard, which would culminate in *less* coordination rather than in our envisaged goal of increased (semi) coordination. We will turn to the implications of the adoption of such a modified Transfer Pricing Directive Proposal within our discussions under Section 4.3.2.2 below.

#### *4.3.1.3. Bilateral Implementation*

Finally, a bilateral implementation, as long perceived by both the Four Economists Report and the Carroll Report, and as illustrated by the maintenance of a primordially bilateral structure of international tax law, in general, and of the ALS/transfer pricing rules, in particular, over the walked *time* evolution assessment, is the most viable implementation structure. This is not to say – and Section 4.3.1.1 and, especially, Section 4.3.1.2 above corroborate – that a multilateral implementation (at least from a *soft law* perspective) and an EU-wide *hard* multilateral implementation is not welcomed, as concluded above. The iterations of the different layers of implementation (and those streams from the partial non-implementation as well) will be discussed in the sections below.

Our envisaged way forward, therefore, foresees a multilateral minimum standard of implementation, under which the *structure* of our proposed solution (i.e., RBC, FASS and SMR) would be encapsulated. The bilateral instruments (i.e., tax treaties) would be left with the role to either establish the *technical elements* (i.e., the *formulas* to be used and the governing of the FASS *exits*), in case the minimum standard does not enforce a prescribed set of elements (i.e., along the lines of our proposed changes to the Transfer Pricing Directive Proposal in Europe) or, in case the minimum standard does contain such, as an *enlarged* minimum standard, to *modified/tailor* such elements to the particular treaty partners.

This approach, especially under an EU *enlarged* minimum standard, ensures feasibility (not requiring constant bilateral negotiations), while still maintaining the possibility of countries to *tailor* the proposed solutions to their economic and political needs, with specific and more relevant treaty partners. This is a similar mechanism as currently existing MLI[656], but, differently than the latter, would already be deemed, at least under an *enlarged* minimum standard perspective, to work without further bilateral analysis.

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656 OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, *op. cit*.

### *4.3.2. Iterations and Disputes Prospectives*

As we have discussed under Section 4.3.1 above, the different levels if implementation, recognizing the practical difficulties, even within a *multilateral* level, to achieve *global* implementation, is very likely to lead to iterations, in specific ALS/transfer pricing cases, between legislations implementing (i.e., *adopting*) or not our proposed solution. The potential iterations and their foreseen consequences, with a special focus on transfer pricing *disputes*, are presented in the sections below.

#### *4.3.2.1. Implementing v. Implementing Cases*

Although apparently with no disputes prospectives, cases involving only implementing jurisdictions can still lead to some disputes if the involved jurisdictions do not have/ have not accordingly amended their bilateral treaties and only a light multilateral level of implementation of our proposed solution was put forward, i.e., no safeguard standard technical elements *enforceably* introduced. Although we have expressly not advocated in favour of this particular level of implementation, we believe that even in these cases, the underlying transfer pricing disputes prospectives shall not be higher than in *current* practice. The (OECD) TNMM current deficiencies and resulting disputes well illustrates our point, as jurisdictions often disagree on *in casu* benchmark studies/results[657].

Still, even within a less recommended *light* multilateral level of implementation, *soft law* technical elements eventually presented under the OECD Transfer Pricing Guidelines might serve as guidance to the resolution of disputes arising from the cases above explained, which could also be used during MAP[658]. Such a support from the soft law instruments of the OECD is currently *non-existent* or, arguably, less existent in terms of the benchmark/TNMM application, which corroborates our idea above that, even in a less desirable scenario of implementation, our proposed solution is likely to create less disputes or, at least, disputes more readily solvable[659], than current OECD ALS *variant*.

#### *4.3.2.2. Implementing v. Non-Implementing Cases*

In cases between *implementing* and *non-implementing* jurisdictions, our disputes

657 *Vide* Table 1, under Section 3.2.1.2 above.

658 *Vide* Section 4.3.3 below, under which we consolidate our opinion in favor of the maintenance of *ex-post* increased coordination measures, such as the MAP, following the introduction of our proposed solution.

659 We acknowledge that, without at least such soft law guidance from the OECD Transfer Pricing Guidelines, MAP procedures can have an additional obstacle, as, then, the contest results would not be taxpayer made x tax authority made, but rather a clash between two tax authorities. This, let it be noted, would not increase disputes in themselves, but could render then harder to solve.

perspectives are actually quite similar as to the exceptional case we have just discussed above, i.e., the cases under which both implementing jurisdictions do not agree to the same exact technical elements to the FASS. As such, our conclusions herein cannot differ from the conclusions already established above.

An interesting note, nevertheless, shall be made. The TNMM FASS, within the terms discussed under Section 4.1.2 above, is meant to be *obligatory* (i.e., not discretionary) to taxpayers and tax authorities alike. Here, we must introduce a flexibilization to such feature, which would kick-in in case of MAP, under which the tax authority of the implementing jurisdiction might agree to a different approach to solve the dispute, based on the terms presented by the opposing (non-implementing) jurisdiction. This flexibility is necessary, not only to allow for effective dispute resolutions in implementing v. non-implementing cases, but also to the cases under the Section above. We do not see a similar exception being applicable to cases of APA, as they might undermine the benefits of the FASS.

#### *4.3.2.3. Non-Implementing v. Non-Implementing Cases*

Finally, still in cases between *non-implementing* and *non-implementing* jurisdictions, our proposed solution can have a positive (i.e., dispute reduction) effect. This can be the case as, if multilaterally implemented (at any level or degree), our proposed solution might serve as a *guidance* towards the analysis of the disputed arm's length results or even as a middle ground solution, readily implementable even prior to formal MAP procedures, as long as the involved jurisdictions have not expressly/formally rejected the reimagined ALS. Naturally, the effectiveness of our proposed solution in reducing ALS/transfer pricing disputes, in cases involving solely *non-implementing jurisdictions*, is rather restricted, but in no way leading to a worst-off scenario when compared to contemporary *praxis*.

### *4.3.3. The Residual Role of Ex-Post Increased Coordination Measures*

As thoroughly discussed above, the *ex-post* increased coordination measures shall be maintained. The importance of both the APA and the MAP is to be retained for the cases under which, even within a hypothetical *global* implementation of our reimagined arm's length standard, a solution could not be found, as we have illustrated in terms of the accurate delineation of the transaction[660]. As we are confident that our reimagined arm's length standard will be capable of addressing many of the cases leading to transfer pricing disputes, this importance shall be constrained to residual cases, in line with what we have already presented above, under Section 3.5.3.1.

A second line/reasoning of the importance of these *ex-post* increased coordination measures is precisely what we have looked at under Section 4.3.2 above. Especially MAP shall remain relevant for cases under which the involved jurisdictions do not

660 *Vide* Section 3.5.3.4 above.

share the same technical elements to the FASS, which will be in bigger or smaller numbers, depending on the level of implementation, but shall always be deemed to exist, given our disbelief on an actually global (universal) common adoption of our proposed solution and the elimination of each and every different ALS *space variants*.

# CHAPTER 5. CONCLUSIONS AND RECOMMENDATIONS

Following the extensive discussions carried out above, we have concluded on the need for the international community to count on efficient mechanisms for allocation of profits between the constituent units of MNEs, safeguarding businesses from double-taxation, but also encapsulating a strong anti-tax avoidance *role* for jurisdictions. Born over a hundred years ago, the arm's length standard has long been applied towards those objectives and, despite a bumpy road and shortcomings, has resiliently shown itself to be the preferred *political* choice for the international community, indicating that the highlighted objectives shall be attained, as within our efforts, through a *reimagination* of the standard, rather than through a (currently unfeasible) rupture with it.

Our *reimagination* efforts were motivated by the pressing needs deriving from the challenges related to the different elements of the arm's length core (i.e., *rationale*, *results*, *compliance requirements*, *roles* and *coordination nature*). Recent years' fast-paced changes in business rationale and the increased magnitude of the challenges to the current ALS *variant* make this study a necessary endeavour in international tax law.

Within the endeavour, our proposed arm's length *variant* encompasses elements of an *enterprise* approach, which are deemed necessary to accommodate for *rational business conducts*, typical in contemporary economy, currently overseen by the OECD. This not only ensures compatibility between the legal provisions and their underlying realities but is also capable of ensuring an adequate unbridged levelling between MNEs and standalone undertakings. Without such a consideration, the arm's length increasingly risks undermining the advantages of group operations and, as such, the international/global economy from a broader perspective. Furthermore, such disregard of the necessary *enterprise* approach elements, in the form of the *rational business conducts*, shall lead to the conclusion on the non-compatibility of current ALS *variant* with the core of the arm's length, which reads as an *undesirable paradox*. From an EU standpoint, as shown, the inability of the arm's length to accommodate for valid commercial justifications, within a group set-up, might render the standard a unproportional restriction to the fundamental freedoms and, as such, non-compatible with EU Law.

Additionally, we have also concluded on the need for the arm's length standard to provide for strengthened *objective* and *verifiable* criteria for its application and scrutiny. According to our assessment, and leveraging from a vast historical and comparative analysis, the use of formula-based alternatives/solutions, as within our proposed *Formulaic-Approach Simplification Safeguard* tool. Current OECD *variant's praxis*, reflected in the transfer pricing methods as per current OECD Transfer Pricing Guidelines, is, in many instances, unable to provide for the necessary tax and legal *certainty*, thus contributing to the dangerous phenomenon of *randomization* of the arm's length *results*, as we have called it. From an EU perspective, this increasing *randomization* represents another risk towards the consideration of the unproportionally of the restrictive effect of the arm's length towards the exercise of the fundamental freedoms and, as such, yet again incompatible with EU Law.

The dissertation has also presented the urge of for the reduction of the *undue administrative constrains* imposed by current ALS to taxpayers (and tax authorities alike) and how, altogether, these challenges are mirrored in an inefficient arm's length standard, uncapable of attaining its objectives – as both a profit allocation and an anti-avoidance mechanism. Finally, it was also presented the challenges around the semi-coordinated nature of the arm's length standard and how increased coordination (i.e., towards *full* coordination) is desired, yet not primordial for the successful implementation of a *reimagination* proposal. We have defended that, waiting for a global agreement/compromise, politically unlikely at this point, would render the international community even further behind the developments in the business rationale and the arm's length responses even more inefficient.

The proposed solutions (*reimagination*) were tested for *compatibility* thus ensuring that our arm's length *variant* is, indeed, at arm's length, i.e., within our established *core* contours, that the *feasibility framework* established was observed and that the standard is compatible with the fundamental instruments underlying its semi-coordinated nature/application. Our reimagined arm's length was also tested for *implementability*, ensuring that the foreseen overall benefits of its implementation would outweigh any potential negative or, as we have identified, partially *neutral* effects. Despite not fully addressing all the identified challenges, it can be concluded, based on the arguments collated along this study, that our proposed reimagined arm's length is more suitable to tackle most of the challenges than current adopted OECD *variant*.

Finally, in times of rapid changes and developments, both in the rationale of global businesses and in (proposed) regulations, we hope this study will present itself as a tool for the international community, professionals and academics, to support, firstly, a more solid, structured and comprehensive understanding on the limits of the arm's length standard and, based on it, to reshape its future, improving the efficiency of the profit allocation exercise within MNEs and, consequently, taking steps in the direction of a more efficient and sustainable corporate income tax scenario for jurisdictions and businesses/taxpayers alike.

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## SUMMARY

The study addressed the *time* and *space* variants evolution of the arm's length standard, as a cornerstone of international tax law. Said evolution aimed at providing for a comprehensive and critical analysis of the constant reshaping of the standard's contours, revealing the challenges it was stretched to tackle and what has stand in the way of its *effective* application. We were able to demonstrate, within this scope of analysis, that the international community still propagates a political support towards the adoption of a *certain* version of the arm's length standard, as a profit allocation and anti-avoidance mechanism. With that in mind, we have established our *feasibility framework*, characterized by the premise that no solutions to the challenges discussed below could be proposed at non-arm's length grounds.

Despite the existence of several studies devoted to the arm's length standard, we have early on perceived the need to more systematically (and comprehensively) revisit this endeavour. Firstly, due to the blistering recent evolution of the arm's length and the scale of its challenges, secondly, because – especially when related to *tax policy* – due to our perceived lack of sufficiently theoretically-based, practically-feasible solutions at the table. From this perception, our efforts to showcase/explore the arm's length standard were based on its constituent elements, its core. We have then understood this core to be composed by elements of *rationale*, *results*, *compliance requirements*, *roles* and *coordination nature*. This created the right basis for us to more efficiently identify the different challenges to the standard's application and how they relate.

After presenting these elements, and the *limits* they inflict on the stretching of a potential *variant* of the arm's length, minding the *feasibility framework* imposed constrains, we proceeded to analyse the main *contemporary* challenges of the arm's length standard, based on each of the *core*'s elements. These challenges were observed from a historic and comparative analysis (*time* and *space* evolution), with the joint *theoretical* and *practical* eyes, using several relevant case laws as background. Despite the international (global) focus of the research (and its underlying *problems*), we have consistently demonstrated the reflexes of the arm's length challenges in an EU scenario, due to our expressed belief that those cause a stronger urge for reimagination of the arm's length in the region, as well as for our identified opportunity of pioneering of the EU in putting forward a globally valid reimagined arm's length standard.

Finally, we have presented the outlines of a reimagined arm's length standard, aimed at systematically addressing the discussed negative effects of the identified challenges. This necessary aim was, nevertheless, followed by a feasibility disclaimer, translated into our theory and practice-based confidence that our reimagined arm's length would be able, if adopted, to positively, yet not completely, tackle the obstacles to an efficient arm's length (and MNE corporate taxation) *praxis*. The proposed reimagined arm's length standard was based on three main elements, our Rational Business Conducts, Formulaic Approach Simplification Safeguard and the Sequential Method Rule. Through these elements, our reimaged arm's length standard encompasses elements of a light *enterprise approach*, within the logic of accounting for legitimate business

interests as well as *formula elements*. Leveraging from a rich time and space history, we believe we have presented the academic and professional community an arm's length for the future, applicable now.

The confidence with which the last statement was drawn comes from a strong compatibility analysis or, rather, test, through which we have confronted our *reimagined* arm's length, not only with our *core* established elements, minding the *feasibility framework*, but also currently available instruments of implementation. Although we did not dare to predict the future, we have foreseen the implementation grounds and steps for our *reimagined* arm's length and are of the firm belief that it would better serve the international community and would significantly contribute to an effective corporate taxation of MNEs in today's world.

## RESUMO

O estudo abordou a evolução das variantes *temporais* e *espaciais* do arm's length standard, como pedra angular do direito fiscal internacional. A referida evolução visou proporcionar uma análise crítica da constante reformulação dos contornos do arm's length standard, revelando as acomodações do standard face aos desafios enfrentados e aquilo que tem impedido a sua *aplicação efetiva*. Pudemos demonstrar, dentro desse escopo de análise, que a comunidade internacional ainda propaga um forte apoio político à adoção de *alguma* versão do arm's length standard, como mecanismo de alocação de lucros tributáveis e antiabuso. Com isso em mente, estabelecemos a nossa *feasibility framework*, caracterizada pela premissa de que nenhuma solução a ser apresentada para os desafios discutidos abaixo poderia ser proposta em bases expressamente *não*-arm's length.

Apesar da existência de vários estudos dedicados ao arm's length standard, desde cedo, percebemos a necessidade de rever este esforço de forma mais *sistemática* (e abrangente). Em primeiro lugar, devido à rápida evolução (e transformações) do arm's length standard e à crescente dimensão dos seus desafios e, em segundo lugar – de forma especialmente relacionada com a *política fiscal* – devido à nossa perceção de falta de soluções outras à mesa que sejam técnica e teoricamente embasadas e exequíveis. A partir dessa perceção, nossos esforços em observar e explorar o arm's length standard foram baseados em seus elementos constituintes, seu *núcleo*. Entendemos, então, que este núcleo é composto por elementos de *racionalidade*, *resultados*, *requisitos formais*, *papéis/funções* e *natureza de coordenação*. Isso nos permitiu estabelecer as bases adequadas para identificarmos de forma mais adequada os diferentes desafios para a aplicação do arm's length standard e como esses desafios se relacionam.

Depois de apresentar esses elementos, e os *limites* que eles impõem à elasticidade de uma potencial *variante* do do arm's length standard, tendo em mente as *restrições impostas pela feasibility framework*, passámos a analisar os principais *desafios, contemporâneos, do arm's length standard*, com base em cada um dos elementos do *núcleo*. Estes desafios foram observados a partir de uma análise histórica e comparativa (evolução *temporal* e *espacial*), com o olhar *teórico* e *prático*, utilizando como pano

de fundo o direito comparado e o recurso a diversos casos de relevância. Apesar do enfoque internacional (global) da investigação (e dos problemas que lhe estão subjacentes), demonstrámos consistentemente os reflexos dos desafios do arm's length standard em um cenário da União Europeia, devido à nossa expressa convicção de que estes suscitam uma ainda maior necessidade de *reimaginação* do arm's length standard na região, bem como pela oportunidade, conforme identificamos, de um pioneirismo da União Europeia na apresentação de um arm's length standard reimaginado, globalmente válido.

Por último, apresentámos os contornos de um arm's length standard reimaginado, destinado a abordar sistematicamente os efeitos negativos discutidos dos desafios identificados. Este objetivo foi devidamente acompanhado de uma declaração de limitações, traduzidas na nossa confiança (teórica e prática) de que o nosso reimaginado arm's length standard seria capaz, caso adotado, de enfrentar positivamente, ainda que não completamente, os obstáculos a uma prática eficaz do standard (e da tributação das empresas multinacionais). A nossa proposta de arm's length standard reimaginado baseou-se, portanto, em três elementos principais: os nossos *Rational Business Conducts*, *Formulaic Approach Simplification Safeguard* e *Sequential Method Rule*. Por meio desses elementos, nosso reimaginado arm's length standard engloba elementos de uma *light enterprise approach*, dentro da lógica de contabilizar interesses legítimos de negócio, bem como elementos de *fórmulas*. Valendo-nos de uma sólida análise histórica (temporal e espacial), acreditamos ter apresentado à comunidade académica e profissional um arm's length standard para o futuro, mas aplicável desde agora.

A confiança com que a última declaração é feita provém de uma forte análise de compatibilidade, ou melhor, de testes, através dos quais confrontámos o nosso arm's length standard reimaginado, não só com os nossos *elementos nucleares* estabelecidos, tendo em conta a nossa *feasibility framework*, mas também com os instrumentos de implementação atualmente disponíveis. Embora não nos tenhamos atrevido a prever o futuro, antecipamos os fundamentos e os passos de implementação para o nosso arm's length standard reimaginado e estamos confiantes de que serviria melhor a comunidade internacional e contribuiria significativamente para uma tributação mais eficaz das empresas multinacionais no mundo de hoje.

## LIST OF PUBLICATIONS

1. Schmitz, Ricardo. "The Legal Nature of Corporate Group's Entities and the Future of Arm's Length Principle and Transfer Pricing". *Contemporary Research on Organization Management and Administration Journal*, 9, 2 (2021). https://cris.mruni.eu/cris/entities/publication/28587e7b-6f29-4190-8796-f782d44aa5d2
2. Schmitz, Ricardo, Putnina, Elina. "An arm's length assessment of the accurate delineation of employee stock option plans". *International Comparative Jurisprudence*, 12 (1) (2026). https://ojs.mruni.eu/ojs/international-comparative-jurisprudence/article/view/9740

## SCIENTIFIC EVENTS WHERE RESEARCH RESULTS WERE PRESENTED

1. The 9th International Scientific Conference for Young Researchers: Social Transformations in Contemporary Societies. Presentation title: The Legal Nature of Corporate Groups Entities: Ideas on the Future of Arm's Length Principle and Transfer Pricing in International Business Taxation. Location: Vilnius, Lithuania. Date: 3, 4 June 2021.
2. Presentation of the research results as part of an intensive course, University of Lisbon. Presentation title: "Transfer Pricing: from the basics to the controversies". Location: Lisbon, Portugal. Date: 21-25 November 2022.
3. TP Coffee, Vienna University of Economics and Business. Presentation title: "MOGAS Case Højesteret Domstol, 6 September 2023". Location: Vienna, Austria. Date: 27 September 2023.
4. Round Table: Professor Pasquale Pistone's, Vienna University of Economics and Business. Presentation title: "Is the Arm's Length a Principle of EU Law?". Location: Vienna, Austria. Date: 29 November 2023.
5. Conference: O passado, presente e futuro do princípio da plena concorrência na União Europeia (*The past, present and the future of the arm's length principle in the European Union*). Presentation title: "Introdução ao princípio da plena concorrência e aos preços de transferência" (*Introduction to the arm's length principle and to transfer pricing*). Location: Lisbon, Portugal. Date: 21 January 2025.
6. Conference: O passado, presente e futuro do princípio da plena concorrência na União Europeia (*The past, present and the future of the arm's length principle in the European Union*). Presentation title: "O princípio da plena concorrência na União Europeia: desafios e perspetivas" (*The arm's length principle in the European Union: challenges and perspectives*). Location: Lisbon, Portugal. Date: 24 January 2025.

## DESCRIPTION OF THE DOCTORAL CANDIDATE'S LIFE, SCIETIFIC AND CREATIVE ACTIVITY

Ricardo Sergio Schmitz Filho is a doctoral candidate in Law at the University of Lisbon and at Mykolas Romeris University, with focus on corporate taxation issues of multinational enterprises, with emphasis on transfer pricing matters. The Doctoral Candidate is a lecturer in 'International Tax Law' and 'Finance and Tax Law' at Mykolas Romeris University in Lithuania, a visiting lecturer in 'Transfer Pricing' at the University of Lisbon and has teaching experience in other institutions abroad. Ricardo Sergio Schmitz Filho is a tax and transfer pricing manager at Deloitte Lietuva, involved in international projects, with expertise on an array fo different industries and clients. The Doctoral candidate has a LL.M degree in European Legal Practice (University of Lisbon), with focus on European and International Tax Law and is graduated in Law at the Federal University of Pernambuco, Brazil. During the last few years, the Doctoral candidate have had the opportunity to conduct studies, to research and to organize legal events all around Europe, with special emphasizes on a reserach stay program, as a guest researcher, at the Institute for Austrian and International Tax Law, at the Vienna University of Economics and Business.

LISABONOS UNIVERSITETO TEISĖS FAKULTETAS
MYKOLO ROMERIO UNIVERSITETAS

**Ricardo Sergio Schmitz Filho**

# A REIMAGINED ARM'S LENGTH STANDARD

Mokslo daktaro disertacijos santrauka
Socialiniai mokslai, teisė (S 001)

Vilnius, 2026

Mokslo daktaro disertacija rengta 2020–2025 metais Mykolo Romerio universitete ir Lisabonos universiteto Teisės fakultete, pagal Mykolo Romerio universitetui ir Vytauto Didžiojo universitetui Lietuvos Respublikos švietimo, mokslo ir sporto ministro 2019 m. vasario 22 d. įsakymu Nr. V-160 suteiktą doktorantūros teisę ir Lisabonos universitetui. Studijų ciklo reglamentu Doutoramento em Direito, Despacho n.º 6321/2016, su pakeitimais, padarytais 2021 m. rugsėjo 21 d. Despacho n.º 8673/2021, suteiktą doktorantūros studijų teisę.

Ši daktaro disertacija parengta vadovaujantis 2022 m. sausio 14 d. „Agreement for the elaboration of a PhD thesis in international co-tutelle regarding Ricardo Sergio Schmitz Filho“, sąlygomis.

*Moksliniai vadovai:*

prof. dr. Ana Paula do Valle-Frias de Madureira e Piedade Dourado (Lisabonos universitetas, Portugalijos Respublika, socialiniai mokslai, teisė, S 001);

prof. dr. Solveiga Vilčinskaitė (Mykolo Romerio universitetas, socialiniai mokslai, teisė, S 001).

Mokslo daktaro disertacija ginama Mykolo Romerio universiteto ir Vytauto Didžiojo universiteto teisės mokslo krypties taryboje, bendrai sudarytoje kartu su Lisabonos universitetu:

*Pirmininkas:*

prof. dr. Virginijus Bitė (Mykolo Romerio universitetas, socialiniai mokslai, teisė, S 001).

*Nariai:*

prof. dr. Rytis Krasauskas (Mykolo Romerio universitetas, socialiniai mokslai, teisė, S 001);

doc. dr. Gustavo Lopes Courinha (Lisabonos universitetas, Portugalijos Respublika, socialiniai mokslai, teisė, S 001);

prof. dr. Vasco Pereira da Silva (Lisabonos universitetas, Portugalijos Respublika, socialiniai mokslai, teisė, S 001);

prof. dr. Michal Radvan (Masaryko universitetas, Čekijos Respublika, socialiniai mokslai, teisė, S 001).

Mokslo daktaro disertacija bus ginama viešame Teisės mokslo krypties tarybos posėdyje 2026 m. rugsėjo 4 d. 15 val. Lisabonos universitete, Teisės fakulteto dekano posėdžių salėje.

Adresas: Alameda da Universidade1649-014, Lisabona, Portugalija.

## SANTRAUKA

Ištiestosios rankos standartas (**"ALS"**) yra tarptautinės mokesčių teisės kertinis akmuo, kuriuo siekiama užtikrinti, kad sandoriai tarp asocijuotųjų šalių tarptautinių įmonių grupių (**"TĮG"**) atveju būtų vykdomi taip, lyg jie būtų vykdomi tarp nesusijusių šalių. 20 amžiaus pradžioje sukurta ALS nuo pat jos įkūrimo buvo kruopščiai tikrinama, nuolat iš naujo vertinama ir diskutuojama, todėl vystosi tiek laiko, tiek erdvės požiūriu.

Jos kontūrai buvo vis dažniau pertvarkomi, siekiant sudaryti sąlygas įprastoms šalims susidoroti su iššūkiais, susijusiais su veiksmingu jos taikymu, kylančiais dėl besikeičiančių ekonominių scenarijų. Įprastų rinkos sąlygų kontūrų elastingumas, atsirandantis po minėto pertvarkymo, atskleidžia tarptautinės bendruomenės politinę valią laikytis tam tikros ištiestosios rankos sąvokos (o ne pasirinkti jos nutraukimą) sprendžiant pajamų mokesčio klausimus, kylančius iš asocijuotų šalių sandorių tarptautiniame kontekste.

1995 m. EBPO Sandorių Kainodaros Gairėse įdiegus naujus metodus, kilus tradicinių metodų krizei, gerokai nukrypta nuo pradinio ištiestosios rankos standarto supratimo. Vis dėlto, užuot pasisakius už ištiestosios rankos atsisakymą, tarptautinės bendruomenės politinėje žinutėje, tvirtai įtvirtintoje tuometinėse naujose Gairėse, pabrėžiamas noras pritaikyti ir pertvarkyti ištiestosios rankos standarto sistemą arba jo koncepciją, kad būtų atsižvelgta į įvestus ypatumus. Taigi, ištiestosios rankos kontūrų, elastingumas.

Ta pati žinia buvo stipriai įkūnyta vėliau 2010-aisiais, kai buvo pradėtas Bazės erozijos ir pelno perkėlimo (**"BEPS"**) projektas. Visų pirma savo 6, 7 ir 8–10 veiksmais EBPO siekė sistemingai spręsti problemas, su kuriomis susiduriama dėl tuometinės dabartinės ALS ir pagrindinės tarptautinių įmonių ekonominės tikrovės neatitikimų, t. y. didėjančių sunkumų suderinti ištiestosios rankos rezultatus su kintančia vertės kūrimo samprata, kuriai didelę įtaką daro pasaulinės ir skaitmeninės ekonomikos atsiradimas. Pagrindinis ištiestosios rankos vaidmuo – pelno paskirstymo mechanizmas – palaipsniui tapo kovos su mokesčių vengimu mechanizmu.

Panašią žinią galima rasti neseniai 2020-aisiais, pradedant EBPO 2019 m. ataskaita dėl ekonomikos skaitmeninimo mokesčių problemų sprendimo (Report on Adressing the Tax Challenges of the Digitalization of the Economy), kurios kulminacija buvo EBPO dviejų ramsčių pasiūlymas. Jie dar kartą patvirtino tarptautinės bendruomenės valią laikytis ALS, net jei jos kontūrai ir toliau keičiasi, ir jos vaidmuo išsiplėtė į tarptautinį apmokestinimo teisių (arba turto) perskirstymą ir antimokestinį konkurencijos mechanizmą. Pastarasis pasiūlymas taip pat priimamas Europos Sąjungos kontekste.

Be to, Europoje tvirtas Europos Komisijos (**"EK"**) palaikymas, iš pradžių įtvirtintas 2016 m. pranešime dėl valstybės pagalbos, o neseniai sustiprintas 2023 m. pasiūlyme dėl sandorių kainodaros direktyvos, atsižvelgiant į kontekstą Verslas Europoje: pajamų apmokestinimo sistema (Business in Europe: Framework for Income

Taxation) (**"BEFIT"**), patvirtina supratimą apie regioninę politinę pirmenybę tam tikro ištiestosios rankos standarto išlaikymui.

Lygiagrečiai su ALS laiko raida (ir su tuo susijusiais laiko variantais), skirtingi aplikatoriai, net jei juos riboja panašūs laiko išdėstymai, neretai nesutaria dėl to, koks turėtų būti ištiestosios rankos rezultatas, ypač pastaruoju metu, atsižvelgiant į didėjantį ekonomikos sudėtingumą ir pagrindinių susijusių šalių verslo logiką. Todėl vis dažniau tokie veiksniai kaip skirtingi tolerancijos lygiai palyginamumo reikalavimams ir ištiestosios rankos rezultatų apytikslis suartėjimas taip pat lemia skirtingą (praktinį) ištiestosios rankos standarto supratimą. Tai vis dažniau atsispindi įvairiuose su įprastomis rinkos sąlygomis susijusios teismų praktikos vertinimuose visame pasaulyje (ypač Europoje).

Taigi šie skirtingi ištiestosios rankos taikymo standartai natūraliai lemia skirtingų ištiestosios rankos standartų egzistavimą ne tik laike, kaip aprašyta aukščiau, bet ir erdvėje. Atsižvelgiant į tai, tyrimu buvo siekiama atsakyti į klausimą: kaip ištiestosios rankos standartas turėtų būti pergalvotas, kad būtų sprendžiami šiuolaikiniai iššūkiai, susiję su pagrindiniais jo logikos elementais, rezultatais, atitikties reikalavimais, vaidmenimis ir koordinavimo pobūdžiu, atsižvelgiant į įgyvendinimo galimybių sistemos nustatytus apribojimus?

Ypatingas dėmesys buvo skiriamas šių iššūkių refleksams ir atsakymams Europos Sąjungoje, ypač atsižvelgiant į Europos teismų praktiką ir konkrečius turimus įgyvendinimo mechanizmus, kurie taip pat atsispindėjo analizėje, atliktoje atsižvelgiant į šio tyrimo tikslus ir uždavinius.

Atsakant į mūsų siūlomą tyrimo klausimą, pirmasis tikslas / uždavinys buvo nustatyti įgyvendinimo galimybių sistemos ir ištiestosios rankos branduolio kontūrus (t. y. loginį pagrindimą, rezultatus, atitikties reikalavimus, vaidmenis ir koordinavimo pobūdį), atsižvelgiant į ištiestosios rankos laiko ir erdvės raidą.

Remiantis laiko ir erdvės variantais ir kryptimis, kuriomis buvo išbandytas ištiestosios rankos elastingumas, **2 Skyriuje** buvo nubrėžtas bendras ištiestosios rankos standarto branduolys, kuris buvo pagrindas tolesniems tyrimams. Pagrindinis dėmesys buvo sutelktas į loginio pagrindo, rezultato, vaidmenų, atitikties reikalavimų ir koordinavimo pobūdžio elementus.

ALS logika – užtikrinti, kad asocijuotų šalių nustatytos finansinės ar komercinės sąlygos būtų tokios, kokios panašiomis aplinkybėmis būtų sudarytos tarp nepriklausomų šalių. Nors ši terminologija kyla iš dabartinės EBPO pavyzdinės mokesčių sutarties 9 straipsnio formuluotės, mūsų anksčiau atlikta ištiestosios rankos variantų analizė šiame skyriuje parodė, kad ši logika vyrauja nuo 1930 m. (ir po Carroll ataskaitos).

Todėl TĮG struktūroje kontroliuojamuose sandoriuose nustatytų sąlygų pasekmės turi apytiksliai atspindėti arba neiškraipyti kiekvieno iš grupę (**"TĮG"**) sudarančių vienetų individualių mokėjimų gebėjimų (principo). Kitaip tariant, paskirstymas turi būti atliekamas atsižvelgiant į kiekvieno TĮG sudarančio vieneto individualų gebėjimą mokėti, t. y. gebėjimas mokėti neturi būti apskaitomas bendrai, vieningai, TĮG pagrindu. Taigi ALS loginis pagrindas negali būti pritaikytas pelno paskirstymo mechanizmams, kuriais neatsižvelgiama į grupės vidaus santykių poveikį TĮG struktūroje, nors tai nereiškia, kad atliekant ALS vertinimą negalima / nereikia atsižvelgti į tam tikrus TĮG būdingus elementus.

Todėl įprastomis rinkos sąlygomis turi būti užtikrinta, kad pelnas būtų apmokestinamas jurisdikcijose, kuriose paprastai kontroliuojamas ar vartojamas turtas arba kuriose gaunamos pajamos, nes jos paprastai atspindi tos jurisdikcijos vaidmenį prisidedant prie mokesčių mokėtojo turto, taigi ir jo gebėjimo mokėti. Mes norėjome parodyti, kad, nors ir buvo pasėta Four Economists Report (praėjusio amžiaus pradžioje), ši idėja nuo to laiko liko praktiškai nepaliesta, nepaisant tarptautinių ir regioninių pasiūlymų, panašių į vieningą apmokestinimą.

Tai, kas turi būti laikoma įprastomis rinkos sąlygomis pasiektu rezultatu ir, galbūt dar svarbiau, kokiais būdais / metodais galima pasiekti tokius rezultatus, raida buvo labiau nerami nei ta, kuri buvo susijusi su pirmiau minėtu ALS loginiu pagrindu.

Iki 1968 m. JAV reglamentų paskelbimo ir tradicinių sandorių kainodaros metodų įvedimo būdai, kuriais TĮG įrodė, kad jų rezultatai atitinka ALS, buvo pagrįsti subjektyviu vertinimu, kas būtų teisinga ir pagrįsta.

Pirmaisiais įprastų rinkos sąlygų standarto vertinimo dešimtmečiais nebuvo jokių objektyvių, griežtų palyginamumo reikalavimų.

Laikytis griežtos palyginamumo sąvokos, kaip vienintelis būdas pasiekti realius ALS suderinamus rezultatus gali būti laikomas egzistavusiu tik nuo 1968 m. (JAV, bet vėliau tarptautiniu požiūriu) iki 1980-ųjų pabaigos, 1990-ųjų pradžios (taigi truko mažiau nei trečdalį ALS chronologinės istorijos). Tiesą sakant, kaip parodėme, aukščiau pabrėžtas terminas “tik” nėra tiksliai teisingas, net ir šiame ribotame chronologiniame pjūvyje, nes dauguma ALS variantų apėmė tai, ką galima pavadinti ketvirtuoju metodu, praktiškai atveriančiu duris platesniems palyginamumo metodams.

Todėl griežtas palyginamųjų metodų taikymas, kaip nustatyta pateiktų tradicinių sandorių kainodaros metodų praktikoje, nėra vienintelis būdas pasiekti ištiestosios rankos rezultatą, todėl platesnio palyginamumo vertinimo rezultatai nebūtinai atitinka ištiestosios rankos reikalavimus.

Nepaisant pradinės politinės kovos dėl sandorių kainodaros metodų, kaip aptarta, jų platesni palyginamumo standartai, bent jau pastaruosius porą dešimtmečių, yra plačiai pripažįstami ir taikomi praktiškai kiekviename ALS erdvės variante. Nors šie nauji palyginamumo standartai grįžta į subjektyvumo būseną, artimesnę pradinio ALS amžiaus būklei (arba galbūt ją pranoksta), buvo teigiama, kad šie nauji palyginamumo standartai yra būtini, kad ALS išliktų pagrindinis tarptautinio mokesčių taisyklių rinkinio elementas.

Laiko raidos vertinimas parodė, kad atliekant palyginamumo analizę, įtrauktą tiek į grynosios maržos metodą, tiek į pelno padalijimo metodą, bent jau teoriškai galima gauti ištiestosios rankos rezultatus.

Galiausiai, atsižvelgiant į skirtingų požiūrių į ištiestosios rankos rezultatus ir jų pasiekimo būdus ir metodus, raida leido daryti išvadą, kad ypač vis sudėtingesnėje ekonomikoje, tiek tarptautinių įmonių, tiek nepriklausomų šalių elgesys yra skirtingas, net jei jis yra panašiomis aplinkybėmis. Todėl sandorių kainodaros / ALS praktikoje reikalingi įmanomi įverčiai, apytiksliai skaičiavimai ir intervalų naudojimas ir, kaip labai gerai nustatyta, turi būti laikomi neprieštaraujančiais ištiestosios rankos rezultatų esmei.

Atsižvelgiant į tai, svarbu pažymėti, kad vieno įprasto rinkos rezultato turėjimas (nors ir retas) taip pat nelaikomas prieštaraujančiu ALS rezultatų branduoliui, nors sutelkimas į jo pasiekimą gali reikšmingai pakenkti ALS įgyvendinimui, reikšmingai neprisidedant prie jo veiksmingumo (t. y. apytikslis ištiestosios rankos rezultatų įvertinimas yra normalus ir nepageidautinas, iki tam tikro masto).

Taigi ištiestosios rankos rezultatų branduolys yra daug atviresnis, nei rodo dabartinis standarto taikymas, nors naudojami metodai visada turi atitikti ištiestosios rankos logiką, o kiti pagrindiniai jo elementai turi būti skirti imituoti rezultatus, kurių būtų galima tikėtis, jei šalys būtų nepriklausomos viena nuo kitos.

Nei bendri palyginamumo reikalavimai, nei apytikslis rezultatų pobūdis nerodo, kad formulės a priori nesuderinamos su ištiestosios rankos rezultatų branduoliu.

Atitikties reikalavimai visada buvo taikomi kartu su ALS praktika, nors jos taikymo sritis labai skyrėsi, ypač susijusi su trimis pagrindiniais palyginamumo supratimo laikotarpiais (ir pagrindiniais tokio palyginamumo įrodymų rinkimu / pateikimu). Šiuo metu daugumos ALS variantų atitikties reikalavimai atsispindi EBPO trijų pakopų dokumentų struktūroje, t. y. šalies byloje, pagrindinėje byloje ir ataskaitoje pagal šalis.

Nors gana sudėtinga užduotis aiškiai apibrėžti ištiestosios rankos standarto atitikties esmę, šiuo požiūriu oficiali atitiktis turi būti įmanoma įrodyti, kad veiklos vykdytojas taiko konkrečios ALS varianto taisyklės taikymo įprastomis rinkos sąlygomis pobūdį. Šiuo požiūriu pagrindiniai atitikties reikalavimų elementai yra neatsiejami nuo ALS rezultatų branduolio, nes kuo tinkamesnė pastarojo struktūra, tuo lengviau ALS veiklos vykdytojams bus įvykdyti teigiamą atitikties reikalavimų branduolio apibrėžimą.

Kita vertus, neigiamu požiūriu, atitikties reikalavimai neatitiktų ALS susitarimo, jei jo pagrindinė administracinė našta arba sąnaudos viršytų (arba užgožtų) kitus pagrindinius ALS elementus. Galiausiai, loginiu požiūriu, dėl taikytinų atitikties reikalavimų jos veiklos vykdytojai (t. y. tarptautinės įmonės) neturi atsidurti labai (neproporcingai) blogesnėje padėtyje nei nepriklausomos įmonės, esančios panašiomis aplinkybėmis, nes dėl to gali būti padarytas nepageidaujamas kompromisas tikrinant TĮG sudedamųjų dalių faktinį individualų gebėjimą mokėti.

Kalbant apie ALS vaidmenį, jie gali būti aptariami kaip pelno paskirstymo mechanizmas, kovos su mokesčių vengimu mechanizmas, apmokestinimo teisių perskirstymo mechanizmas arba antikonkurencinis mechanizmas.

Remiantis mūsų laiko raidos vertinimu, atrodo neginčijama, kad pradinis ištiestosios rankos standarto vaidmuo (arba tikslas) buvo tarnauti kaip pelno paskirstymo mechanizmas, kad būtų sudarytos sąlygos tarptautiniam ekonomikos augimui, apribojant tarptautinio dvigubo apmokestinimo situacijas. Tai aiškiai matyti iš ALS sėklų analizės prieškario dvejopo apmokestinimo išvengimo sutartyse ir iš pagrindinių problemų, kuriomis grindžiami pirminiai mūsų analizuoti dokumentai. Ištiestosios rankos kaip pelno paskirstymo mechanizmo vaidmuo visada egzistavo, todėl jis suvokiamas kaip būtinas ALS vaidmuo.

Kovos su mokesčių vengimu mechanizmo vaidmuo nebuvo aiškiai paminėtas pradiniuose dokumentuose, kuriuose minima ALS ar jos sėklos, nes jis buvo pateiktas tik 1934 m. JAV Vidaus pajamų įstatymo (US Internal Revenue Act of 1934) 45 skirsnio teisės aktuose / oficialiuose dokumentuose, nors ir labai nedrąsiai. Šis susirūpinimas buvo stipresnis nuo 1970-ųjų ir 1980-ųjų, kaip ir 1988 m. Baltoji knyga (White Paper), nuo to momento nuolat augo.

Nuo BEPS projekto pradžios sistemingiau ALS buvo laikoma (svarbia) priemone pasaulinėje kovoje su mokesčių vengimu, o šis vaidmuo taip pat pripažįstamas EBPO Sandorių Kainodaros Gairėse.

Vis dėlto kai kuriais atvejais ALS netgi buvo laikoma priemone, atliekančia pagrindinį kovos su mokesčių vengimu vaidmenį, kaip kai kuriose svarbiose bylose Italijos Aukščiausiajame Teisme. Nors mes tikrai negalime pritarti šiai minčiai, šiuo metu (ir numatomai į priekį) neįmanoma atskirti ištiestosios rankos standarto nuo šio vaidmens. ALS turi rūpintis ne tik dvigubu apmokestinimu, bet ir dvigubu neapmokestinimu.

Dar visai neseniai ALS laiko raida parodė, kad ji gali būti taikoma kaip apmokestinimo teisių perskirstymo mechanizmas. Taip yra dėl didėjančio pasaulinio susirūpinimo dėl pasaulinio mokesčių pyrago dalių pasidalijimo skirtingoms jurisdikcijoms, atsižvelgiant į besikeičiančią ekonominę realybę.

Apmokestinimo teisių perskirstymo vaidmuo atsirado EBPO I ramsčio pasiūlymo kontekste (tiesą sakant, jau nuo "BEPS 2.0 pradžios"). Nors nesupratome, kad tokia iniciatyva būtinai prieštarauja ALS, kai kurie jos punktai tebėra diskutuotini, kaip jau aptarėme pirmiau. Dėl neaiškumų, susijusių su faktiniu I ramsčio ("Amounts" A ir B) įgyvendinimu, ypač palyginti su nusistovėjusiu ALS paskirstymo ir kovos su vengimu vaidmenimis (kartu su gana ribota I ramsčio taikymo sritimi), šis apmokestinimo teisių perskirstymo vaidmuo yra gana neprivalomas konkrečiam ALS variantui. Kitaip tariant, mes nemanome, kad šis vaidmuo yra būtinas ištiestosios rankos branduoliui arba būtinai jam prieštarauja.

Galiausiai, galimas ALS, kaip antikonkurencinio mechanizmo, vaidmuo susijęs su tuo, kad šis standartas gali sumažinti lengvatinių mokesčių režimų, kuriuos tam tikros jurisdikcijos taiko siekdamos pritraukti dirbtinę ekonominę veiklą / pelną, veiksmingumą, nes juo ribojamas TĮG priskirtinas pelnas toje konkrečioje jurisdikcijoje, jei reali ekonominė veikla nevykdoma (arba sumažėja). Be to, ALS taip pat turėtų užkirsti kelią vienašališkam alternatyvių paskirstymo mechanizmų taikymui, kurie galiausiai gali sąmoningai lemti (bent iš dalies) dvigubą neapmokestinimą ir lengvatinį netikros veiklos apmokestinimo režimą.

Nors mes nesutelkėme dėmesio į šiuo metu vykdomą EBPO II ramsčio pasiūlymą (ir jį pagrindžiančią ES direktyvą), svarbu pažymėti, kad jis gali būti laikomas atsakingu už stipresnį (precedento neturintį) prieš mokesčius nukreiptą (jurisdikcinę) konkurencinį vaidmenį tarptautinių įmonių apmokestinimo praktikoje. Nors šis dokumentas nėra tiesiogiai susijęs su ištiestosios rankos standartu (ar galimais tiesioginiais pakaitalais), tinkamas jo taikymas suponuoja tinkamą ALS taikymą, taigi yra neatsiejamas nuo vėlesnio.

Todėl ta pati išvada, kaip ir pirmiau minėto apmokestinimo teisių perskirstymo mechanizmo atveju, taikoma įprastomis rinkos sąlygomis veikiančio branduolio vaidmens ir antikonkurencinės funkcijos santykiui.

Galiausiai, paskutinis nustatytas ALS branduolio elementas buvo jos koordinavimo pobūdžio elementas. Ištiestosios rankos standartas atsirado kaip dvišalis kylančios dvigubo apmokestinimo problemos sprendimas, priešingai grynai vienašališkoms, vidaus priemonėms, turinčioms tokį tikslą (vaidmenį), kaip JAV kredito metodas, įvestas 20 amžiaus pradžioje.

Šiomis aplinkybėmis ALS buvo abipusėmis nuolaidomis pagrįstos sistemos, pagrįstos tam tikru sutartu pagrindu, rezultatas. Be to, pirminė idėja buvo daugiašalis tokių abipusių nuolaidų priėmimas. Todėl ALS reikalauja tam tikro lygio koordinavimo, kad galėtų atlikti savo pirminį vaidmenį. Visiškai nesuderintas standartas negali būti laikomas įprastomis rinkos sąlygomis.

Kita vertus, pusiau koordinacinis pobūdis visada persmelkė ALS praktiką. Kaip parodėme, jis prasidėjo kaip antras geriausias sprendimas (arba laikinas statusas) link vaizduojamo daugiašališkumo, tačiau greitai buvo laikomas įgyvendinamu sprendimu, į kurį tarptautinė bendruomenė nusprendė sutelkti dėmesį (atsižvelgiant į dvišalį ne tik ALS, bet ir visos tarptautinės mokesčių praktikos pobūdį). Šiuo metu tiek EBPO Sandorių Kainodaros Gairių taikymas keliuose nacionaliniuose teismuose, kaip pagrindinis ALS aiškinimo vadovas, tiek plačiai priimta EBPO pavyzdinės apmokestinimo sutarties 9 straipsnio formuluotė dvigubo apmokestinimo išvengimo sutarčių tinkle rodo, kad tam tikru mastu ALS yra pusiau koordinuotas.

Nors daugiašališkumas (ar bent jau jo idėja) pastaraisiais metais iš tiesų ryškėja sandorių kainodaros srityje, taip pat ir regioniniu (ES) požiūriu, pakanka pusiau koordinuoto pobūdžio, kad būtų laikomasi ištiestosios rankos , nors kuo labiau siekiama visiško ALS elementų koordinavimo, tuo veiksmingesnis jis turėtų būti.

Visiškai koordinuotos ALS egzistavimas (t. y. vieningas) buvo, kaip minėta, pradinė idėja labai ankstyvame ištiestosios rankos vystymosi amžiuje. Paaiškėjo, kad tai neįmanoma ir iki šiol niekada nebuvo pasiekta (ir nebus pasiekta trumpuoju ar vidutinės trukmės laikotarpiu), nes pasiūlymas dėl sandorių kainodaros direktyvos, nors ir apsiriboja ES scenarijumi, yra artimesnis dokumentas (dar pasiūlymo stadijoje), kuris neabejotinai (ir iš dalies) įgyvendins šį tvirtesnio koordinavimo idealą.

Šiuo atžvilgiu, nors ir pageidautina, visiškas ALS koordinavimas (galiausiai lemiantis vieno varianto egzistavimą erdvėje) visai nėra ALS branduolio būtinybė.

Siekiant nuoseklių apytikslių ištiestosios rankos rezultatų, užtikrinant, kad būtų laikomasi vieno apmokestinimo principo (nei dvigubo apmokestinimo, nei dvigubo neapmokestinimo), ištiestosios rankos standartas turi būti priimtas bent jau pusiau koordinuotai visame pasaulyje, siekiant (artimesnio) visiško koordinavimo ateityje. Tinkamas ištiestosios rankos veikimas, laikantis pagrindinių jo elementų, užtikrina tinkamą standarto, kaip kovos su mokesčių vengimu mechanizmo, veikimą, nes jo taikymas taip pat gali būti susijęs su pastangomis, susijusiomis su (jurisdikcinių) apmokestinimo teisių perskirstymu ir antikonkurencinėmis priemonėmis, kaip pastaraisiais metais vis dažniau matyti tarptautinėse diskusijose.

Apibendrinant galima teigti, kad ištiestosios rankos standartas yra pelno paskirstymo mechanizmas, taikomas siekiant užtikrinti, kad skirtingų TĮG sudedamųjų dalių nustatytos sąlygos atspindėtų jų individualų gebėjimą mokėti arba veikiau neiškraipytų jo ir nepakenktų būdingiems požymiams, pateisinantiems verslo veiklos vykdymą grupės pavidalu. Rezultatai, atspindintys šias įprastas rinkos sąlygas, būtinai turi būti pagrįsti tam tikra palyginamumo analize, atsižvelgiant į rezultatus, kurių būtų buvę galima tikėtis, jei nepriklausomos šalys būtų buvusios panašiomis aplinkybėmis. Atsižvelgiant į ekonominę realybę, susijusią su bet kokio įprastomis rinkos sąlygomis taikomu taikymu, ištiestosios rankos taikymas negali būti grindžiamas nei griežtu palyginamumu, nei pavieniais rezultatais, taigi gaunamas apytikslis ištiestosios rankos pobūdis. Jos atitikties reikalavimai yra būtini siekiant užtikrinti ištiestosios rankos rezultatų patikimumą, tačiau tarptautinėms įmonėms negali tekti gerokai papildomos reikalavimų laikymosi naštos, palyginti su atskiromis įmonėmis.

Išnagrinėję ALS laiko ir erdvės raidą ir iš jos išvedę branduolį (su jos sudedamaisiais elementais) ir galimybių sistemos kontūrus, šiame branduolyje galėjome aptarti dar vieną disertacijos tikslą ir uždavinį, kuris buvo pagrįstas pagrindinių iššūkių įvertinimu kiekvienam iš nustatytų ištiestosios rankos branduolio elementų, kaip jie kenkia veiksmingam pelno, gauto iš asocijuotųjų šalių sandorių, apmokestinimui ir pateisina poreikį pertvarkyti ištiestosios rankos standartą.

Efektyvaus tarptautinių įmonių pajamų apmokestinimo iššūkiai (atsižvelgiant į asocijuotųjų šalių dinamiką) dar niekada nebuvo tokie akivaizdūs ir neatidėliotini. Šis teiginys taip pat galioja Europos Sąjungoje dėl jame įžvelgiamų ypatumų ir pagrindinių padarinių, ypač susijusių su kliūtimis naudotis pagrindinėmis laisvėmis ir (mokestinės) valstybės pagalbos draudimu, todėl kyla pavojus, kad priemonės, kuriomis siekiama paskirstyti pelną pelno mokesčio tikslais, bus laikomos nesuderinamomis su Sutartimi dėl Europos Sąjungos veikimo (**“SESV”**) ir ES teise apskritai.

Tyrime buvo aptarta, kas, autoriaus nuomone, yra didžiausi iššūkiai ištiestosios rankos standarto taikymui, kurie, kaip manoma, pagrindžia šį skubų poreikį pergalvoti ištiestosios rankos standartą. Iškelti uždaviniai yra glaudžiai susiję su pirmiau nurodytais elementais, susijusiais su ištiestosios rankos pagrindu (loginis pagrindas, rezultatai, vaidmenys, atitikties reikalavimai ir koordinavimo pobūdis).

Taigi **3 Skyriuje** nagrinėjami pagrindiniai iššūkiai, susiję su veiksmingu ištiestosios rankos standarto taikymu tarptautiniu / bendruoju požiūriu, ir tai, kaip šie iššūkiai atsispindi ES, atsižvelgiant į jų galimą poveikį (dabartinės) ALS suderinamumui su SESV.

Pirma, tiek laiko, tiek erdvės variantų ALS raida rodo, kad griežtas subjekto požiūris yra nepakankamas, atsižvelgiant į jo neatitikimą pasauliniam verslo logikai, suintensyvėjusiems pastaraisiais dešimtmečiais. Kaip įrodyta, išlaikant griežtą subjekto požiūriu pagrįstą ALS kyla pavojus, kad tarptautinės įmonės ir nepriklausomos įmonės susilygins. Dėl to gali sumažėti ekonominis efektyvumas ir sinergija, kurie galiausiai pateisina grupės veiklą. Griežtas subjekto požiūriu pagrįstas ALS laikomas netinkamu logiškiems (arba racionaliems) verslo sprendimams, kurie yra prasmingi

TĮG struktūroje, tačiau tai būtų pastebima nepriklausomų šalių elgesyje – tai, ką mes vadiname racionaliu verslo elgesiu.

Iššūkiai, susiję su griežto subjekto požiūriu grindžiamo ALS nepakankamumu, taip pat atsispindi ES, todėl minėta ALS paprastai nesuderinama su ES teise. Kaip parodėme išanalizavę Europos Sąjungos Teisingumo Teismų (**"ESTT"**) praktiką, šis nesuderinamumas atsirastų dėl to, kad griežtu subjekto požiūriu grindžiama ALS gali neišlaikyti pagrindimo testo ESTT pagrindinės laisvės vertinime – iššūkis, kurio preliudija jau galima rasti aptartuose sprendimuose ir nuomonėse, ypač SGI ir Hornbach-Baumarkt bylose.

Įmonių požiūrių alternatyvos nustatytiems loginiams iššūkiams ES, bet platesnės, buvo pateiktos kaip taškai (arba intervalai) subjekto ir įmonės požiūrio *continuum* – visiškas ir ribotas griežtas subjekto požiūris, po kurio sekė lengvas įmonės požiūris, kurio kulminacija buvo kietas įmonės požiūris. Skiriamasis elementas buvo tai, kaip skirtingos sąlygos (ir aplinkybės) tarp skirtingų tarptautinių įmonių vienetų yra prilyginamos tam tikram ALS variantui.

Mes padarėme išvadą, kad lengvos įmonės požiūris turėtų būti pajėgus įvesti į ALS praktiką privalomą laikymąsi to, ką mes vadiname racionaliu verslo elgesiu, taip potencialiai sprendžiant problemas, susijusias su griežto subjekto požiūriu pagrįstos ALS nepakankamumu – loginio pagrindo klausimas. Vis dėlto pridūrėme, kad struktūriškai įgyvendinus lengvą įmonių požiūrį pagrįstą ALS gali atsirasti neigiamas šalutinis poveikis didesniam subjektyvumui vertinant įprastas rinkos sąlygas, padidėti mokesčių ir teisinis neapibrėžtumas bei ginčai dėl sandorių kainodaros. Todėl bet koks bandymas įgyvendinti lengvą įmonės požiūrį turi būti daromas derinant su papildomomis priemonėmis.

Šio griežto subjekto įprastomis rinkos sąlygomis taikomo standarto neveiksmingumą taip pat atspindi apribojimai, su kuriais susiduriama taikant sandorių kainodaros metodus, pagrįstus to pačio subjekto logika, daugiausia dėmesio skiriant palyginamumo trūkumo iššūkiams, dėl kurių galiausiai gali būti pakenkta ištiestosios rankos rezultatams. Remdamiesi ALS laiko raidos vertinimu, parodėme, kaip didėjantis palyginamųjų metodų trūkumas persmelkė tradicinių sandorių kainodaros metodų taikymą ir kaip šis reiškinys paskatino sukurti sandorių metodus, t. y. grynosios maržos metodą ir pelno pasidalijimo metodą, siekiant susigrąžinti prarastą palyginamumą. Vis dėlto sandorių metodai padidino sandorių kainodaros praktikos subjektyvumą ir sudėtingumą, taip pat atsirado papildomų iššūkių (arba trūkumų), kaip minėta pirmiau. Tai baigėsi tuo, ką mes vadiname atsitiktinės atrankos procesu ištiestosios rankos rezultatams, priešingai nei toleruotinas šių rezultatų apytikslis lygis.

Problemos, susijusios su sandorių kainodaros metodų nepakankamumu, taip pat atsispindi ES, todėl dabartinės ALS alternatyvos yra nesuderinamos su ES teise. Šis nesuderinamumas susijęs ne tik su ESTT vertinimais pagrindinių laisvių bylose, kaip pirmojo skundo srityje, bet ir su (mokestinės) valstybės pagalbos draudimu.

Pirmuoju atveju buvo įrodyta, dėl to, kad sandorių kainodaros metoduose nebuvo palyginamų duomenų ir į juos įtraukti atsakymai, dėl kurių minėti ištiestosios rankos rezultatai buvo atsitiktinai atrinkti, nepateikiami objektyvūs ir patikrinami kriterijai, kurie laikomi būtinais siekiant pagrįsti ribojančią ištiestosios rankos nuostatą ES, kaip nurodyta aptartoje ESTT praktikoje, ypač transliacija iš SGI. Antra, toleruotino apytikslio lygio ekstrapoliacija, pagal kurią gaunami atsitiktiniai rezultatai, turėjo keletą pasekmių EK inicijuotos (mokestinės) valstybės pagalbos atvejais. Bylose "Starbucks", "Fiat", "Apple" ir "Amazon" sandorių kainodaros metodų nepakankamumas paskatino ilgas diskusijas dėl galimo šioms įmonėms suteikto atrankiojo pranašumo buvimo, nes buvo klaidingai patvirtintos ALS pragmatinės išraiškos išankstinių susitarimų dėl kainodaros procesuose.

Formule pagrįsta alternatyva (**"FPA"**) yra alternatyvos nustatytiems rezultatų iššūkiams ES ir platesnėje erdvėje, galinčios suteikti trūkstamus patikrinamus ir objektyvius ALS praktikos kriterijus ir sumažinti sudėtingumą. Skirtingi FPA apima dar vieną *continuum* – nuo griežtesnių versijų, kai tarptautinės įmonės traktuojamos kaip konsoliduotas vienetas (t. y. įmonės požiūris) pagal itin griežtą FPA, iki švelnesnių, labiau pritaikytų programų. Itin kieti, kieti ir lengvi FPA taškai mūsų siūlomame *continuum* skiriasi, kaip minėta, dviem elementais: (i) jų pasitikėjimu įmonės arba subjekto požiūriu ir (ii) jų orientuotu tikslu imituoti apytikslį ištiestosios rankos rezultatą, atsižvelgiant į mūsų apibrėžtą termino supratimą.

Mes padarėme išvadą, kad tik lengvas FPA būtų suderinamas su mūsų nupieštu ALS branduoliu. Aptarėme keletą pagrindinių klausimų, susijusių su lengvojo FPA įvedimu į ALS praktiką, įskaitant jo argumentuotą savivalę, galimas problemas, susijusias su dabartinių ALS variantų (ne FPA) iteracijomis, galimus apskaitos apribojimus ir padidėjusį jautrumą manipuliacijoms. Nors pripažįstame tam tikrą priežastį, dėl kurios kyla kai kurie iš aukščiau aptartų pagrindinių klausimų, mes padarėme išvadą dėl tam tikro lengvo FPA priėmimo ALS praktikai naudos.

Be to, buvo sprendžiami su atitikties elementais susiję uždaviniai. Mokesčių mokėtojams (ir mokesčių administracijoms) taikomi nepagrįsti administraciniai suvaržymai ne tik lemia didelį tarptautinių įmonių ekonominės veiklos savaimingumo mažinimą ir dideles papildomas viešąsias išlaidas, bet ir ES kontekste gali lemti tolesnį nesuderinamumą su SESV ir dar vieną naudojimosi pagrindinėmis laisvėmis apribojimų rinkinį. Be numanomo neigiamo dabartinio išsamesnių sandorių kainodaros metodų taikymo poveikio, pernelyg didelis techninis sudėtingumas taip pat prisidėjo prie daugumos garsių pastarojo meto fiskalinės valstybės pagalbos bylų ESTT, pvz., "Fiat" ir "Apple", ir ESTT lygmeniu, pavyzdžiui, "Starbucks".

Buvo pristatyti esami atitikties supaprastinimo apsaugos mechanizmai (pvz., dokumentų išimčių ribos) ir supaprastinimo apsaugos mechanizmai (t. y. sąlygos, būtinos supaprastintam arba formulėmis pagrįstam požiūriui įgyvendinti konkrečiuose ALS erdvės variantuose).

Argumentuotas pagrindimas ir rezultatų nesėkmė lemia suvokiamą dabartinės ALS nesugebėjimą susidoroti su savo teorizuojamais vaidmenimis. Tyrimas parodė, su kokiais iššūkiais susiduria ištiestosios rankos standartas atliekant šiuos vaidmenis ir kaip jie galiausiai padaro standartą ne tik atsitiktinį, kaip nurodyta aukščiau, bet ir labai neveiksmingą.

Be nustatytų iššūkių, pusiau koordinuotas ištiestosios rankos pobūdis kelia papildomų svarbių iššūkių standarto taikymui ar administravimui. Taigi tyrime iš naujo apžvelgtos šio koordinavimo pobūdžio šaknys ir skirtingi kliūčių rinkiniai (ir lygiai) aukštesniam tarptautinės ir ES praktikos koordinavimo lygiui, taip pat atsižvelgiant į nustatytus ištiestosios rankos erdvės variantus.

Buvo aptartos pusiau koordinuoto dabartinio ištiestosios rankos standarto pasekmės padidėjusiems ginčams dėl sandorių kainodaros apskritai ir kliūtims naudotis pagrindinėmis laisvėmis, atsižvelgiant į galimus diskriminacinius apribojimus, taip pat (fiskalinę) valstybės pagalbą.

Nustatę, kad egzistuoja ne viena ALS, o keli jos laiko ir erdvės variantai ir, žinoma, kad egzistuoja ne ištiestosios rankos sprendimai dėl apmokestinamojo pelno paskirstymo tarp tarptautinių įmonių sudedamųjų dalių, dėl kurių priimami skirtingi priimtų sprendimų koordinavimo lygiai, taip pat nustatėme galimus iššūkius, kylančius dėl šių iteracijų. Dėl šių iššūkių gali atsirasti dvigubo apmokestinimo atvejų.

Nors ES kontekste visiško koordinavimo trūkumas neprieštarauja ES teisės aktui dabartiniame tiesioginių mokesčių integracijos etape, pripažįstame, kad, ypač remiantis EK atliktu darbu, pageidautina didesnio pusiau koordinavimo lygio. Aukštesnis pusiau koordinavimo lygis iš tiesų gali sumažinti kliūtis naudotis pagrindinėmis laisvėmis, bet taip pat padėti sumažinti ginčus, pavyzdžiui, pirmiau aptartose (fiskalinės) valstybės pagalbos bylose.

Kaip alternatyvos (priemonės) siekiant didesnio skirtingų ištiestosios rankos standartų koordinavimo, sustiprinto koordinavimo sprendimai pateikiami dviejose kategorijose: i) *ex-post* sustiprinto koordinavimo sprendimai ir ii) *ex-ante* sustiprinto koordinavimo sprendimai. Pirmoji kategorija apima Advanced Pricing Agreement (**"APA"**) ir Mutual Agreement Procedure (**"MAP"**), o antroji kategorija apima sustiprintas EBPO Sandorių Kainodaros Gaires ir pavyzdinę apmokestinimo sutartį. Žvelgiant iš ES perspektyvos, kaip minėta, pirmoji kategorija bus analizuojama per EK ir teismų sprendimų prizmę, o antroji kategorija bus analizuojama per galimo ES sandorių kainodaros minimalaus standarto prizmę

Nepaisant klausimų, susijusių su politiniais ir bendro sutarimo apribojimais, padarėme išvadą, kad jie nėra kliūtis *ex-ante* priemonių įgyvendinimui, o dėl didelių administracinių apribojimų *ex-post* priemonės turi būti taikomos išimtiniais atvejais (veikiau likutiniu atveju) – būtina, kaip nurodyta pirmiau, tačiau platesniame ALS permąstymo kontekste tikimasi, kad bus naudojamasi mažiau.

Remiantis pirmiau minėtų tikslų ir uždavinių įgyvendinimu, tyrimu taip pat buvo siekiama pasiūlyti ištiestosios rankos standarto taikymo (permąstymo proceso) pakeitimus, kurie būtų skatinami ir galintys spręsti neigiamą analizuojamų iššūkių poveikį, atsižvelgiant į įgyvendinimo galimybių sistemos apribojimus.

Naršant nuo problemų iki galimų sprendimų, **4 Skyriuje** buvo pasiūlyti permąstyto ištiestosios rankos standarto kontūrai, pagrįsti trijų pagrindinių elementų konstrukcija: Rational Business Conduct (**"RBC"**) alternatyva, Formulaic-Approach Simplification Safeguard (**"FASS"**) ir Sequential Method Rule (**"SMR"**). Jomis siekiama spręsti uždavinius, susijusius atitinkamai su ištiestosios rankos branduolio loginiu pagrindimu, rezultatais, vaidmenimis ir atitikties reikalavimų elementais. Koordinavimo pobūdžio elementas sprendžiamas taikant konkrečią mūsų siūlomo sprendimo įgyvendinimo sistemą. Kartu šiomis priemonėmis turėtų būti galima sumažinti neigiamą nustatytų uždavinių poveikį, atsižvelgiant į neišvengiamus apribojimus, nustatytus galimybių sistemoje.

Autoriaus nuomone, apversta logika, dabar įtvirtinta ištiestosios rankos standarte (taisyklė, palyginti su išimtimi), daro heraklišką užduotį jo vykdytojams nustatyti apytikslį ištiestosios rankos rezultatą. Taigi, kaip pirmąjį žingsnį, siūlomu sprendimu bandoma sušvelninti šią inversiją, siūlant įvesti lengvųjų įmonių požiūrio elementus į ištiestosios rankos logiką. Jie įtraukti į RBC alternatyvos idėją ir turėtų padėti išplėsti priimtinus ištiestosios rankos komercinius pagrindimus, taip pat palengvinti ESTT proporcingumo testo išlaikymą.

Mūsų RBC alternatyva yra siūlomas mechanizmas, skirtas sistemingai taikyti lengvą įmonės požiūrį į mūsų perkurtą ištiestosios rankos variantą, kuris nėra nei sistemingai nagrinėjamas, nei aiškiai paminėtas EBPO Sandorių Kainodaros Gairėse. Pristatydami lengvą įmonių metodų spektrą, mes apibūdinome jį galimybe, atliekant sandorių kainodaros vertinimą, neatsižvelgti į sandorius (t. y. ne kainodarą), jei tai būtų pagrįsta komercine priežastimi, kuri dabar atsispindi mūsų RBC pasiūlyme.

Mūsų supratimu, išimties tvarka į sąlygą gali būti neatsižvelgiama tais atvejais, kai abi susijusios šalys tiesiogiai gauna naudos iš nagrinėjamos sąlygos, tais atvejais, kai dėl nesusieto išlyginimo nepriklausoma įmonė neturėtų tiesioginės naudos (t. y. per pačią sąlygą) iš tokios sąlygos, išskyrus piniginę (ar lygiavertę) kompensaciją už tokios sąlygos nustatymą / sandorį – pvz., atvejis Hornbach-Baumarkt. Šios sąlygos nėra tos, kurias sunku įkainoti, techniniu požiūriu. Klaidingai nepaisydamas sąlygų vien dėl techninių sunkumų nustatant kainas (sąlygas), RBC taptų alternatyva pagal griežtos įmonės metodus, todėl nesuderinama su mūsų ištiestosios rankos branduoliu, kaip jau nustatėme.

RBC dinamika yra būtina, kad ištiestosios rankos loginis pagrindas atitiktų šiuolaikines verslo realijas ir užtikrintų, kad tarptautinės įmonės nebūtų baudžiamos už tai, kad vykdo verslą tokioje struktūroje (t. y. laikinas išlyginimas), o tai kenkia pagrindinei naudai, kuri galiausiai pateisina grupės veiklą. Galų gale, nepalaikymas RBC taikymui gali sukelti didelę kliūtį ekonomikos globalizacijos tęstinumui.

Žvelgiant iš ES perspektyvos, RBC įvedimas yra labai svarbi priemonė siekiant užtikrinti ALS būdingo ribojamojo pobūdžio proporcingumą, atsižvelgiant į ESTT pagrįstumo testą. Todėl mūsų RBC gali užtikrinti, kad ALS atitiktų SGI "bet kokio komercinio pagrindimo įrodymą".

Nors EBPO Sandorių Kainodaros Gairėse RBC nėra aiškiai paminėtas, vis dėlto jose aptariamos kelios panašios frazės ar idėjos, kurias reikia atskirti nuo mūsų siūlomos priemonės.

Pirma, EBPO Sandorių Kainodaros Gairėse pateikiama komerciškai racionali sąvoka, kuri vartojama keliose gairių vietose, tačiau veikiau susijusi su galimu sandorių (t. y. sąlygų) nepaisymu, kai juos lydi mokesčių vengimo schemų dirbtinumas, siekiant iškraipyti tikslų sandorių apibrėžimą. Mūsų RBC tam neskiriamas dėmesys, nors mes pabrėžėme tikslaus sandorio apibrėžimo svarbą, taip pat mūsų pergalvotą ištiestosios rankos standartą.

Antra, EBPO Sandorių Kainodaros Gairėse pateikiama paprastos akcininkų veiklos neįkainojimo, apibūdinamos kaip "veikla, kurią vykdo TĮG narys (paprastai patronuojanti bendrovė arba regioninė kontroliuojanti bendrovė) vien dėl to, kad turi nuosavybės teisę į vieną ar kelis kitus grupės narius, t. y. kaip akcininkas". Tose pačiose gairėse taip pat teigiama, kad "tokio pobūdžio veikla nebūtų laikoma grupės vidaus paslauga, todėl nebūtų pateisinamas mokestis kitiems grupės nariams. Vietoj to, su tokio pobūdžio veikla susijusios išlaidos turėtų būti padengiamos ir paskirstomos akcininko lygmeniu".

Mes aptarėme akcininkų veiklos atvejį, diferencijuojant tai, ką Aitor Navarro įdomiai vadina (ir mes priėmėme) sąlygas ir aplinkybes, nustatytas tarp susijusių šalių. EBPO Sandorių Kainodaros Gairės akcininkų veikla yra aplinkybių, kurios visais atvejais neįkainojamos atliekant sandorių kainodaros vertinimą, pavyzdžiai. Mūsų RBC nurodo, kaip pakartotinai atkurta, išimtines sąlygas pagal lengvą įmonės požiūrio prizmę, kuri, be aplinkybių, neturi būti įkainota.

Toks tam tikrų sąlygų nepaisymas neišvengiamai padidintų sandorių kainodaros vertinimo subjektyvumą, todėl siūlome RBC taikyti tik tada, kai mokesčių mokėtojas gali įrodyti jo taikymo pagrįstumą, vietoj standartinio metodo. Žinoma, suprantame, kad šių nuopelnų ribos bus aiškesnės po laipsniško akademinės bendruomenės ir teismų praktikos darbo siekiant išvalyti ribas, kas praktiškai gali būti suprantama kaip RBC reikalavimų vykdymas.

Todėl darytina išvada, kad jei mokesčių mokėtojas atitinka RBC kriterijus, sąlyga neįkainojama ir sandorių kainodaros vertinimas baigiasi. Priešingai, daugeliu atvejų, kai turi būti nustatomos sąlygos, jų kiekybinis įvertinimas turėtų būti nustatomas pagal toliau pateiktą FASS ir laikantis nuoseklios SMR taisyklės.

Kitaip nei kai kurie anksčiau atlikti nesėkmingi bandymai pertvarkyti ištiestosios rankos standartą, siūlomas sprendimas yra daug lengviau pasiekiamas idėja gerokai padidinti ištiestosios rankos rezultato teisinį tikrumą (priešingai nei esama atsitiktinė atranka), užuot bandžius jį (nepakeliamai sudėtingesnį) padaryti "teisingą". Kategoriškas pripažinimas, kad minėto "teisingo" rezultato praktiškai neįmanoma pasiekti, būtų tarptautinės mokesčių praktikos etapas - ir, autoriaus nuomone, labai svarbus. Vietoj to pastangos ir energija turėtų būti skiriamos problemos kampams, kuriuos galima lengviau pertvarkyti. Su iššūkiais, su kuriais susiduria dabartiniai ištiestosios rankos metodai, susidūrė autoriaus idėja dėl FASS ir bus aprašyti kiti susiję siūlomi dabartinių metodų pakeitimai, siekiant suteikti ALS objektyvų ir patikrinamą pobūdį, taip pat geriau suderinti jį su ESTT nuomone. FASS diskusijose taip pat bus pristatytos įgyvendinimo ribos. Jie yra neatsiejami nuo poreikio sumažinti ALS pernelyg didelius administracinius suvaržymus, kurie, mūsų nuomone, gali sukelti didelių problemų vertinant ESTT būtinumą Europoje.

Šiame kontekste mūsų numatomas permąstymo sprendimas apima bendrą lengvomis formulėmis pagrįsto sprendimo, kurį vėliau pavadinome FASS, įvedimą.

Kaip mes siekėme parodyti savo svarstymais viso tyrimo metu, atsižvelgdami į šiuolaikinį verslo scenarijų (loginį pagrindimą), iššūkiai ištiestosios rankos rezultatams užteršė ne tik standarto veikimą išskirtinėmis aplinkybėmis (t. y. sunkesniais atvejais). Įprastų rinkos sąlygų / sandorių kainodaros metodų nepakankamumas daro įtaką (arba atspindi) kasdienę mūsų dalyko praktiką, daro įtaką didelei rezultatų daliai. Tai reiškia, kad, kaip jau minėjome, mūsų nustatyta atsitiktinės atrankos problema yra net tų – teoriškai – lengvesnių atvejų produktas.

Nors analizuojama EBPO I ramsčio B suma atrodo atitinkanti šį supratimą, joje siūlomas gana siauras sprendimas, apsiribojantis tuo, ką EBPO vadina "bazine rinkodaros ir platinimo veikla". Tai apima, pvz., pirkimo-pardavimo rinkodarą ir platinimą bei pardavimo agentūrų ir komisarų sandorius, kaip jau pateikėme aukščiau pateiktame laiko raidos vertinime.

Priešingai, mūsų lengvasis FPA turėtų turėti platesnę taikymo sritį. Kitaip tariant, jis neturėtų būti paliktas išimtiniams / sunkesniems atvejams, atskleidžiant *panacea* kitiems, taip pat neturėtų būti apribotas segmentu / sandorio tipu (pvz., bazine rinkodaros ir platinimo veikla), atskleidžiant lengvesnius atvejus, susijusius, pvz., su gamyba ir paslaugomis. Taigi mūsų siūlomas sprendimas turi šį teiginį kaip prielaidą.

Todėl šis plataus masto FPA turi būti sukurtas taip, kad būtų taikomas kartu su dabartiniais EBPO ALS alternatyviais metodais (pvz., iš anksto nustatytomis kainomis, iš anksto nustatytų lyginamųjų tyrimų rezultatais arba formulės elementais, atitinkamai palyginamosios nepriklausomos kainos, grynosios maržos ir pelno pasidalijimo metodais). Tai vėlgi yra platesnis sprendimas nei siūlomas pagal B sumą, kuri taikoma tik grynosios maržos atvejais.

Taigi mūsų *ex-ante* elementai ALS praktikai, atsižvelgiant į mūsų lengvojo FPA idėją, gali būti nustatyti naudojant fiksuotą į įprastos rinkos sąlygas panašų apytikslį rezultatą / intervalą (pvz., fiksuotą išlaidų antkainį, kaip sunkiai nustatomos vertės nematerialusis turtas (**"LVAS"**) dinamikoje) arba centralizuotai (t. y. daugiašaliu, dvišaliu) parengtu įvertinimu apytikslis rezultatas / intervalas (pvz., tam tikros pramonės šakos grynosios maržos metodo lyginamasis indeksas). Nors pirmajame išlaikomas administraciniu požiūriu paprastesnis metodas, antrasis galėtų padėti patikrinti, ar supaprastintas metodas iš tikrųjų atitinka ALS, taip išvengiant neryškių linijų su sunkesne FPA versija, o tai nėra sveikintina.

Kaip ir Amount B ir, tiesą sakant, kaip laiko raidos vertinimo išvados refleksas dėl platesnio grynosios maržos metodo (t. y. transakcinio metodo) taikymo palyginamosios nepriklausomos kainos metodo (t. y. tradicinio metodo) akivaizdoje, pageidautina, kad mūsų lengvasis FPA būtų taikomas grynosios maržos metodo sistemoje. Tai reiškia, kad jis taikomas tol, kol dabartiniame EBPO alternatyvių vertinimų metu yra grynosios maržos metodo taikymo sąlygos, kaip aptarta, pvz., EBPO Sandorių Kainodaros Gairių 2.65–2.67 punktuose.

Skirtingai nei Amount B, nors ir pripažįstama, kad gali būti atvejų, kai palyginamosios nepriklausomos kainos taikymas taip pat gali būti laikomas taikytinu (ir, ko gero teoriškai tinkamesnis), mūsų grynosios maržos metodas FPA vis tiek turi viršenybę, kaip sustiprintas reikalingų objektyvių ir patikrinamų kriterijų garantas

ALS praktikoje (mokesčių ir teisinis tikrumas), išskyrus atvejus, kai sandorių šalys yra jurisdikcijose, kurios sandorio objektui yra priėmusios dvišalį / daugiašalį palyginamosios nepriklausomos kainos FPA (t. y. nustatytą konkrečios prekės kainą). Nors Amount B pateikia šios palyginamosios nepriklausomos kainos pasitraukimo galimybę kaip gana išskirtinę, ji gali būti daug labiau ištirta pagal mūsų platesnę lengvojo FPA taikymo sritį (pvz., apimančią sandorius su žaliavomis).

Antrasis išėjimas į standartinį grynosios maržos metodą FPA būtų grindžiamas neįprastu bandomosios šalies funkciniu profiliu, leidžiant vietoj to taikyti pelno padalijimo metodą. Kai taikomas pelno padalijimo metodo pasitraukimas, sandorio kaina nustatoma pagal dabartinį EBPO pelno padalijimo metodo variantą arba, jei dėl to susitaria susijusios jurisdikcijos, pagal FPA pelno padalijimo metodą. FPA pelno padalijimo metodo dizainas, be abejo, yra sudėtingesnis administraciniu požiūriu, tačiau gali semtis įkvėpimo iš metodų, pateiktų ankstyvosiose ALS laiko raidos stadijose, pavyzdžiui, Four Economists Report ir Carroll ataskaitoje - nieko naujo po saule.

Lygiagrečiai su pirmąja (Four Economists Report), mūsų FPA pelno padalijimo metodas galėtų būti panašus į mokesčių padalijimo metodą, pagal kurį, kaip paaiškinome, galimi principai kriterijai / formulė gali būti pardavimo vertė, panaudotas kapitalas, išlaikytas nekilnojamasis turtas ar turto vertės, išmokėtas darbo užmokestis ir kreditai bei atsargos, laikomos kiekvienoje jurisdikcijoje.

Kaip ir Carroll ataskaitoje, mūsų FPA pelno padalijimo metodas gali būti panašus į dalinio paskirstymo metodą (pvz., taikomą tam tikrose jurisdikcijose / JAV valstijose), pagal kurį formulės elementai gali būti pagrįsti tokiais veiksniais kaip pardavimas, darbo užmokestis ir turtas. Nors Carroll'as aiškiai parodė susirūpinimą dėl šio metodo savavališkumo (ir apskritai dėl formulių naudojimo), dėl jo pernelyg supaprastinimo, turime interpretuoti autoriaus poziciją atsižvelgdami į dabartinę ištiestosios rankos evoliucijos realybę. Kaip jau aptarėme aukščiau, mes nematome, kad (lengvas) FPA atneštų tam tikrą savivalės lygį į ALS praktiką, ypač pelno padalijimo metodo srityje, kuris būtų didesnis nei dabartinė savivalė, atsirandanti iš atsitiktinių rezultatų. Net jei būtų galima ginčytis dėl panašaus lygio savivalės, geriau paprastesnis nei pernelyg sudėtingas kitas.

Konkrečių svarbų pridėjimas prie formulių elementų, pagrįstų, pvz., skirtingomis pramonės šakomis / sandorių tipais, gali būti įdomus kompromisas tarp objektyvių ir patikrinamų kriterijų ir faktinio ketinimo imituoti ištiestosios rankos rezultatą, sumažinant tai, ką Carroll'as kadaise pavadino pernelyg supaprastintu, atsižvelgiant į dar didesnį subjektyvumą, susijusį su įnašų, kuriais grindžiama pelno padalijimo metodo paraiška / pasitraukimas, unikalumu.

Jei jokie išėjimai taikomi (t. y. palyginamosios nepriklausomos kainos arba pelno padalijimo metodai), tada grynosios maržos metodo FPA įsijungia.

Svarbu pažymėti, kad pagal mūsų pasiūlymą šis supaprastinimo metodas nėra neprivalomas, nors toliau pateiktos RBC išimtys bus taikomos, jei mokesčių mokėtojai palaiko jo privalumus. Todėl šis taikymo *juris tantum* pobūdis pateisina apsaugos terminą (kaip nustatyta FASS). Kitaip tariant, jei susijusios jurisdikcijos susitarė dėl

FASS įvedimo, jo taikymas negali būti pasirenkamas, kitaip nei siūlomos Amount B atveju, ir mokesčių mokėtojai ir mokesčių administratoriai privalo jo laikytis.

Mūsų grynosios maržos metodo FASS padės nedelsiant išspręsti keturias iš penkių pagrindinių grynosios maržos metodo problemų, kurias mes nustatėme.

Iš pradžių, remiantis Amount B, grynosios maržos metodo FASS turi būti nustatytos taisyklės, kaip tinkamai apskaityti sąnaudų bazę, kuriai taikomas atitinkamas pelno lygio rodiklis (**"PLI"**). Dėl to būtų racionalizuotas sąnaudų bazės pasirinkimas, taigi būtų pašalintas arba bent jau gerokai sumažintas iššūkis, susijęs su tinkamu sąnaudų bazės pasirinkimu grynosios maržos metodo taikymui.

Antra, priėmus grynosios maržos metodo FASS turi būti galima gerokai sumažinti klausimus, susijusius su patikima informacija apie potencialiai palyginamą, suprantamą kaip praktinius iššūkius, susijusius su *in casu* lyginamojo indekso palyginamąja atranka (t. y. paieškos strategijos nustatymu), dėl kurių kyla tiek daug ginčų, kaip parodyta pirmiau. Daugiausiai nesutarimų gali kilti dėl daugiašaliu (arba dvišaliu) pagrindu sukurto pagrindinio lyginamojo standarto, jei jis taikomas, tačiau tai neatsispindėtų dabartinėje *in casu* ginčų *panacea*. Atskiri (t. y. šiuo atveju) lyginamieji indeksai vis dar gali egzistuoti, nors jų vaidmuo būtų sumažintas ir taptų tik verslo gairėmis mokesčių mokėtojams, bet nebebūtų tiesioginių mokesčių tikslais (dėl ALS / sandorių kainodaros).

Trečia, taip pat turi būti gerokai sušvelninti pateikti uždaviniai, susiję su palyginamumo analizės koregavimu. Pagal dabartinę praktiką, kaip matyti ir iš pirmiau pateiktos teismų praktikos analizės, grynosios maržos metodo taikymo koregavimai dažnai yra labai subjektyvūs ir nesutarimų objektas, retai pagrindžiantis faktinį palyginamumo pagerėjimą. Todėl grynosios maržos metodo FASS turi būti objektyvios ir ribotos koregavimo galimybės. Siekiama užtikrinti, kad mokesčių ir teisinis tikrumas (objektyvūs ir patikrinami kriterijai) būtų viršesni už neaiškius (daugeliu atvejų, kaip ką tik minėta, tikriausiai neįmanomus) patikslinimus.

Tinkama idėja galėtų būti galimybė išplėsti standartinį diapazoną arba naudoti tam tikrą diapazono dalį, jei būtų patikrinti tam tikri veiksniai (koregavimai) – vėlgi, reikia tinkamai pasirūpinti, kad grynosios maržos metodo FASS objektyvumas nebūtų reikšmingai sumažintas.

Galiausiai, grynosios maržos metodo FASS taip pat turi apimti priemones, skirtas išvengti sutrikimų dėl anachroniško rezultatų taikymo kintančių ekonomikos ciklų akivaizdoje. Todėl formuliniai (*ex-ante*) jos taikymo elementai turi būti periodiškai peržiūrimi ir turi būti įdiegti mechanizmai, pagal kuriuos būtų galima pradėti papildomus atnaujinimus esant ypač svarbioms ekonominėms aplinkybėms, nesvarbu, ar jos būtų bendros (pvz., COVID, karas Ukrainoje ir kt.), ar tai būtų konkrečios pramonės šakos (pvz., žaliavų trūkumas, reikšmingas paslaugų paklausos padidėjimas ir kt.), nors pripažįstame, kad tokie atnaujinimai gali būti sudėtingi, ypač konkretesnėms pramonės šakoms.

Bet kuriuo atveju, nors sunkumai veiksmingai inicijuojant atnaujinimus gali pakenkti grynosios maržos metodo FASS veiksmingumui ir jo faktinėms galimybėms imituoti faktinį analizuojamo laikotarpio rezultatą, nemanome, kad dėl to padėtis būtų gerokai blogesnė nei dabartinis daugiametis EBPO požiūris į grynosios maržos metodo taikymą. Kaip toliau aptarsime įgyvendinimo skirsnyje, daugiašalis (ar net regioninis, t. y. ES masto) FASS įgyvendinimas galėtų būti labai naudingas sprendžiant šį sunkumą.

Vis dėlto įvedus grynosios maržos metodo FASS vis tiek nebūtų galima išspręsti bandomosios šalies funkcinio profilio nustatymo klausimo. Skirtumas tas, kad (atsižvelgiant į darbą, atliktą aplink SMR) klausimas būtų perkeltas iš metodo pasirinkimo (t. y. grynosios maržos vs. pelno padalijimo metodas) pagal EBPO Most Appropriate Method (**"MAM"**) ir verčiau būtų parodyta, ar mokesčių mokėtojas turi pasitraukti iš pelno padalijimo metodo pagal mūsų FASS dinamiką. Atpažįstama, kad tai ta pati problema, tik pateikta kitu sandorių kainodaros metodo taikymo momentu.

Be to, šį klausimą galima atspindėti suprantant, su kokiu iš anksto nustatytu rezultatu lyginti analizuojamą sandorį, kada ir ar toks rezultatas nustatomas pagal pramonės šakų / sandorių grupes (panašiai, kaip siūloma Amount B).

Bet kokiu atveju, atsižvelgiant į mūsų permąstymo tikslą, FASS grynosios maržos metodo padėtis netaptų blogesne, nes būtų sunku suprasti tikrinamos šalies funkcinį profilį, o EBPO pastangos tiksliai apibrėžti sandorį turi būti tinkamai taikomos, kaip numatyta dabartinėse EBPO Sandorių Kainodaros Gairėse. Tam tikras subjektyvumo lygis visada egzistuos taikant ALS, kaip ir praktiškai viskas teisinėje srityje.

Tikimasi, kad (neprivalomai įgyvendinamas) pelno padalijimo metodas FASS (pasitraukimas) taip pat sušvelnins neigiamą dabartinių pelno padalijimo metodo iššūkių poveikį, kaip nurodyta šiame tyrime, t. y. nustatant elementus, lemiančius pelno padalijimą, ir kiekvieno iš jų svorį. Taip pat nesitikima, kad standartinis grynosios maržos metodo FASS, pelno padalijimo metodo FASS (pasitraukimas) išspręs šalių funkcinio profilio nustatymo iššūkį / klausimą, tačiau mūsų siūlomame sprendimo projekte tai bus išankstinis pelno padalijimo metodo FASS (pasitraukimo) klausimas, nes mokesčių mokėtojas turi teisę tik į pelno padalijimo metodo FASS (pasitraukimas), kai toks funkcinis profilis anksčiau buvo laikomas atitinkančiu šio metodo taikymą.

Vis dėlto pripažįstame, kad FASS neturėtų visiškai pakeisti dabartinių EBPO metodų. Todėl dvi situacijų grupės, t. y. finansiniai sandoriai ir situacijos, kurių ekonominis vertinimas laikomas tinkamiausiu testavimo metodu, iš pradžių pateikiamos kaip išimtys, todėl vėliau atliekamas sandorių kainodaros vertinimas, kaip ir šiuo metu pagal EBPO taisykles. Nors ir nerekomenduojama, nes papildomos išimtys gali pakenkti FASS veiksmingumui, į sumažinimą gali būti įtrauktos papildomos situacijos, kurios taip pat gali būti padarytos laipsniškai įgyvendinant FASS pagal konkretų scenarijų.

Vis dėlto atkreipkite dėmesį, kad tai yra FASS, o ne RBC taikymo išimtys. Jei suinteresuotoji šalis / mokesčių mokėtojas pritaria RBC taikymui, pastarasis turėtų lemti sąlygą, kuriai netaikoma kaina, neatsižvelgiant į bet kokį galimą būsimą testavimą kaip finansinį sandorį arba pagrįstą ekonominiu vertinimu.

Mes padarėme išvadą, kad mūsų lengvasis FPA pats savaime nėra svetimas dabartiniam EBPO variantui ir gali būti lengvai įgyvendinamas ALS praktikoje.

Galiausiai SMR buvo pateikta kaip operatyvinė taisyklė, pasirengusi įtvirtinti ir reglamentuoti ne tik siūlomų RBC ir FASS, bet ir šių ir esamų sandorių kainodaros metodų iteracijas. Tyrime aprašoma, kaip be tokio bendro (ir koordinuoto) RBC ir FASS įgyvendinimo, kurie iš esmės skiriasi, siūlomo sprendimo sėkmė būtų smarkiai pakenkta.

Naujų elementų (ir jų iteracijų) buvimas mūsų pergalvotoje ištiestosios rankos ir sandorių kainodaros praktikoje neišvengiamai reikalauja iš naujo įsivaizduoti ir jų taikymą reglamentuojančias taisykles (ir vėlgi, jų iteracijas). Nors nei JAV Best Method Rule (**"BMR"**), nei EBPO MAM nelaikomi pakankamais / tinkamais tokiai paraiškai / iteracijoms reguliuoti, mūsų siūlomas SMR turi būti įkvėptas tiek BMR, tiek MAM.

Iš pradžių, kitaip nei jo pirmtakai, mūsų SMR aiškiai teikia pirmenybę vienam iš metodų – mūsų standartiniam (apsauginiam) grynosios maržos metodo FASS. Taip pripažįstamas ne tik praktinis grynosios maržos metodo paplitimas, nors dabartinis EBPO variantas, kaip dažniausiai taikomas sandorių kainodaros metodas, bet ir numatoma nauda, kurią formulių įvedimas per grynosios maržos metodo sistemą gali duoti mūsų aptartiems iššūkiams. Šio metodo pirmenybė (išversta kaip apsaugos priemonė) taip pat pagrindžia mūsų idėją, kad grynosios maržos metodo FASS, jei netaikomos išimtys, mokesčių mokėtojams ir mokesčių institucijoms nebus neprivaloma, kai ją įgyvendins atitinkama jurisdikcija.

Kiekvienas galimas alternatyvus grynosios maržos metodas FASS taikomas laikantis konkrečios sekos, kuri ne tik padidina teisinį ir mokestinį tikrumą, bet ir gerokai sumažina administracinę naštą, palyginti su (subjektyvesniu) tinkamo metodo pasirinkimo pagrindimu.

Galiausiai svarbu pažymėti, kad SMR nėra MAM, net ir RBC pasitraukimo atveju. Tokiu atveju, kai FASS nebus taikomas dėl RBC pasitraukimo, mes susiduriame su sąlyga, kuri neturi būti įkainota, nors paprastai tai būtų nepriklausomos šalies nustatymas. Todėl mokesčių mokėtojas nesiimtų kito, t. y. tariamai tinkamesnio kainodaros metodo, o pereitų prie ne kainodaros scenarijaus, kaip jau aptarėme.

Natūralu, kad perkurtos ALS suderinamumas su sintezuotu branduoliu ir galimybių sistema, parengta 2 Skyriuje, yra labai svarbūs ir buvo nuodugniai išanalizuoti. Šiuo tyrimu siekiama turėti ne tik tvirtą teorinį stuburą, bet ir reikšmingą praktinę reikšmę dabartinėms diskusijoms, todėl suderinamumas buvo analizuojamas keliais aspektais, t. y. su nusistovėjusiu ALS branduoliu, EBPO standartu ir jo instrumentais, taip pat su ES pagrindinėmis laisvėmis ir (fiskalinės) valstybės pagalbos draudimu.

Siūlomi siūlomų sprendimų įgyvendinimo metmenys taip pat priklausė nuo mokslinių tyrimų. Nors moksliniai tyrimai tinka pasauliniu mastu, jie bus sutelkti į palankesnį pirmąjį įgyvendinimo etapą ES mastu.

Šis pirmojo žingsnio pasirinkimas grindžiamas ne tik suvokiamais stipresniais (aktualesniais) ALS iššūkių ES refleksais, palyginti su bendrąja ir tarptautine perspektyva, bet ir todėl, kad manome, kad dabartinis integracijos lygis (ir pagrindinės teisinės ir politinės priemonės) regione gali labai paskatinti ES permąstyti ištiestosios rankos standartą.

Jei šis (politinis) pionierius (ar netgi protagonizmas) materializuosis, tuomet ES galėtų užimti pagrindinį vaidmenį ALS evoliucijos procese – tai, ką paprastai atlieka JAV, kaip parodys mūsų laiko evoliucijos vertinimas. Priešingu atveju regioniniu lygmeniu permąstyta ALS vis tiek galėtų bent iš dalies sušvelninti atspindėtą neigiamą nustatytų bendrų uždavinių poveikį ES, greičiausiai taip pat kristalizuoti ES teisę atitinkančią ALS atmainą tiek pagrindinės laisvės, tiek (fiskalinės) valstybės pagalbos požiūriu.

Be to, taip pat bus aptariami numatomi ES priimto sprendimo ir dabartinio EBPO / tarptautinio standarto variantai, jei jie nebus bendrai pakeisti. Buvo deramai pasirūpinta, kad siūlomi įgyvendinimo pagrindai nedarytų neigiamo poveikio pirmiau nurodytai suderinamumo analizei.

Autorius mano, kad jei pirmasis ES žingsnis neperaugs į globalų sprendimą, pokyčiai nesukels papildomų ginčų dėl sandorių kainodaros ir neatrodys galintys pakeisti pusiau koordinuoto ištiestosios rankos pobūdžio pasauliniu mastu. Priešingai, tyrime pateikiami argumentai, rodantys, kaip šis pirmasis žingsnis, nepašalinant su sandorių kainodara susijusių ginčų, siūlomas sprendimas iš tikrųjų gali reikšmingai (ES viduje) ir nuosaikiai (ES ir ne ES situacijose) prisidėti prie minėtų ginčų mažinimo. Taip pat reikėtų tikėtis, kad siūlomi sprendimai sumažins reikalavimų laikymosi naštą.

Apskritai, einant siūlomu keliu ir sprendžiant aukščiau pabrėžtus elementus, tyrimu siekiama reikšmingai prisidėti prie diskusijų apie neatidėliotiną poreikį pergalvoti ištiestosios rankos standartą. Kaip aprašyta toliau pateiktame neigiamame tyrimo temos apibrėžime, tyrimas nėra investuojamas į pretenzingą idėją išspręsti visus nustatytus pagrindinius iššūkius, susijusius su ištiestosios rankos standarto taikymu. Kita vertus, autorius įsitikinęs, kad solidžiai išanalizuota siūlomų pakeitimų įgyvendinimo galimybių sistema – ne tik grynai teisinis, bet ir daugiadisciplininis požiūris, leis moksliniams tyrimams suteikti tarptautinei mokesčių bendruomenei efektyvias priemones, paruoštas įgyvendinti, kad būtų galima greitai padėti sušvelninti svarbias ištiestosios rankos standarto taikymo problemas.

Kaip aprašyta šio tyrimo projekto įžangoje, pakeitimai, pasiūlyti kaip atsakymai į suformuluotą tyrimo klausimą, buvo rasti pagal parengtą galimybių sistemą. Pirmoji galimybių sistemos prielaida yra ta, kad asocijuotųjų šalių verslas vis tiek bus apmokestinamas pelno mokesčiais. Pažymėtina, kad kai kurie autoriai siūlo sprendimus, nesusijusius su pelno mokesčiais, kurių teorinis pagrindas yra patrauklus. Šių sprendimų analizė nebuvo atlikta tyrime.

Antra, tyrime siūlomi sprendimai nebuvo lyginami su jokiu viršnacionaliniu pelno mokesčiu. Nors teoriškai įmanoma turėti tarptautinį (arba Europos) vieningą pelno mokestį (pvz., globojant kokiai nors Pasaulinei mokesčių institucijai), tyrimas nukrypsta nuo prielaidos, kad toks šuolis nuo mokesčių suverenumo neįmanomas pagal galimybių sistemą.

Trečia, tyrime nebuvo pasiūlyti sprendimai dėl efektyvaus asocijuotųjų šalių pelno apmokestinimo, kuris atvirai būtų taikomas ne įprastomis rinkos sąlygomis. Tai nereiškia, kad ištiestosios rankos kontūrų elastingumas nebuvo išbandytas / užginčytas. Neigiamas tyrimo temos apibūdinimas yra susijęs su mokesčių politikos įtaka šiam teisiniam tyrimui, nes jokie atviri sprendimai nelaikomi perspektyviais pagal parengtą galimybių sistemą.

Be to, tyrimu nėra siekiama rasti tobulą sprendimą, t. y. tyrimo tikslas nėra pateikti visapusišką ir galutinį analizuojamų iššūkių sprendimą. Tai galioja tiek teoriniu, tiek praktiniu požiūriu. Šio tyrimo prielaida yra tai, kad toks sprendimas arba neegzistuoja, arba pareikalautų tokio lygio kompromiso iš jo operatorių, kuris nebūtų įgyvendinamas trumpalaikėje ir vidutinės trukmės perspektyvoje.

Todėl mokslinių tyrimų sėkmė turėtų būti analizuojama atsižvelgiant į tai, ar moksliniai tyrimai sugebėjo pateikti sprendimus, kurie, palyginti su dabartiniu scenarijumi, suteikė geresnių įrankių, leidžiančių sumažinti kai kuriuos neigiamus analizuojamų iššūkių padarinius.

Galiausiai, tikėtinas tyrime siūlomų pokyčių / permąstymų mokestinis poveikis buvo analizuojamas tik iš pelno mokesčio perspektyvos. Nors suprantame esminius ryšius tarp skirtingų mokesčių rūšių, susijusių su asocijuotų šalių verslo operacijomis, šios pasekmės (pvz., pridėtinės vertės mokesčio požiūriu) paliekamos vėlesniam tyrimui.

Pagrindinis argumentas, ginamas šioje teisės daktaro disertacijoje, yra tas, kad dabartinis EBPO ištiestosios rankos variantas negali efektyviai spręsti šiuolaikinių iššūkių, sukeliančių skirtingus elementus ištiestosios rankos branduoliui. Be pertvarkymo proceso, kurį būtų galima lengvai įgyvendinti laikantis ištiestosios rankos, tarptautinė bendruomenė rizikuoja pakenkti tarptautinių įmonių pelno apmokestinimo veiksmingumui, o tai gali lemti ne tik didelį mokestinių pajamų praradimą (arba netinkamą jų paskirstymą), bet ir kliūčių tarptautiniam ekonomikos augimui sukūrimą, daro tiesioginį poveikį toms pačioms tarptautinėms įmonėms.

Nors tam, ką dabar vadiname permąstymo procesu, buvo pasiūlyta daug sprendimų, manoma, kad jie buvo išsamūs, nes juose nebuvo subalansuoti neišvengiami teisės teorijos ir poliso elementai, atsižvelgiant į sparčiai besivystančią šios srities raidą pastaraisiais metais. Esame įsitikinę, kad šis tyrimas prisidės prie šios spragos panaikinimo (pradžios) ir sudarys pagrindą struktūrizuotai, stipriai teorija pagrįstai, politiškai įgyvendinamai, istoriškai nuosekliai diskusijai apie būtinus ALS patobulinimus ir atitinkamai veiksmingą pelno, gauto iš tarptautinių įmonių veiklos, apmokestinimą.

## AUTORIAUS PUBLIKACIJOS DISERTACIJOS TEMA

1. Schmitz, Ricardo. "The Legal Nature of Corporate Group's Entities and the Future of Arm's Length Principle and Transfer Pricing". *Contemporary Research on Organization Management and Administration Journal*, 9, 2 (2021). https://cris.mruni.eu/cris/entities/publication/28587e7b-6f29-4190-8796-f782d44aa5d2
2. Schmitz, Ricardo, Putnina, Elina. "An arm's length assessment of the accurate delineation of employee stock option plans". *International Comparative Jurisprudence*, 12 (1) (2026). https://ojs.mruni.eu/ojs/international-comparative-jurisprudence/article/view/9740

## PRANEŠIMAI MOKSLINIUOSE RENGINIUOSE

1. The 9th International Scientific Conference for Young Researchers: Social Transformations in Contemporary Societies. Presentation title: The Legal Nature of Corporate Groups Entities: Ideas on the Future of Arm's Length Principle and Transfer Pricing in International Business Taxation. Location: Vilnius, Lithuania. Date: 3, 4 June 2021.
2. Presentation of the research results as part of an intensive course, University of Lisbon. Presentation title: "Transfer Pricing: from the basics to the controversies". Location: Lisbon, Portugal. Date: 21-25 November 2022.
3. TP Coffee, Vienna University of Economics and Business. Presentation title: "MOGAS Case Højesteret Domstol, 6 September 2023". Location: Vienna, Austria. Date: 27 September 2023.
4. Round Table: Professor Pasquale Pistone's, Vienna University of Economics and Business. Presentation title: "Is the Arm's Length a Principle of EU Law?". Location: Vienna, Austria. Date: 29 November 2023.
5. Conference: O passado, presente e futuro do princípio da plena concorrência na União Europeia (*The past, present and the future of the arm's length principle in the European Union*). Presentation title: "Introdução ao princípio da plena concorrência e aos preços de transferência" (*Introduction to the arm's length principle and to transfer pricing*). Location: Lisbon, Portugal. Date: 21 January 2025.
6. Conference: O passado, presente e futuro do princípio da plena concorrência na União Europeia (*The past, present and the future of the arm's length principle in the European Union*). Presentation title: "O princípio da plena concorrência na 7. União Europeia: desafios e perspetivas" (*The arm's length principle in the European Union: challenges and perspectives*). Location: Lisbon, Portugal. Date: 24 January 2025.

## GYVENIMO, MOKSLINĖS IR KŪRYBINĖS VEIKLOS APRAŠYMAS

Ricardo Sergio Schmitz Filho studijavo Lisabonos universiteto ir Mykolo Romerio universiteto teisės mokslo krypties doktorantūroje. Jo mokslinių tyrimų sritis – tarptautinių įmonių apmokestinimas, ypatingą dėmesį skiriant sandorių kainodaros klausimams. Ricardo Sergio Schmitz Filho dėsto kursus „Tarptautinė mokesčių teisė“ ir „Finansų ir mokesčių teisė“ Mykolo Romerio universitete, yra kviestinis dėstytojas Lisabonos universitete, kur dėsto „Sandorių kainodarą“, taip pat turi dėstymo patirties kitose užsienio aukštojo mokslo institucijose. Jis dirba „Deloitte Lietuva“ mokesčių ir sandorių kainodaros vadybininku, dalyvauja tarptautiniuose projektuose ir yra sukaupęs patirties dirbdamas su įvairių sektorių klientais bei skirtingomis pramonės šakomis. Ricardo Sergio Schmitz Filho yra įgijęs Europos teisės praktikos magistro (LL.M.) laipsnį Lisabonos universitete, specializuodamasis Europos ir tarptautinės mokesčių teisės srityse, taip pat yra baigęs teisės studijas Pernambuko federaliniame universitete Brazilijoje. Per pastaruosius kelerius metus jis turėjo galimybę vykdyti mokslinius tyrimus, studijuoti ir organizuoti teisės srities renginius visoje Europoje. Ypač reikšminga buvo Ricardo mokslinė stažuotė Vienos ekonomikos ir verslo universiteto Austrijos ir tarptautinės mokesčių teisės institute, kuriame stažavosi kaip kviestinis tyrėjas.

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A REIMAGINED ARM'S LENGTH STANDARD: daktaro disertacija. – Vilnius: Mykolo Romerio universitetas, 2026. P. 218.

Bibliogr. 176–188 p.

*The study proposes a reimagination of the arm's length standard, putting forward a series of integrated solutions, based on a combined systematic introduction of both rational business conducts and formula-based alternatives to the arm's length praxis. This reimagination effort is necessary to tackle the main identified challenges to the different core elements of the arm's length standard, i.e., rationale, results, compliance requirements, roles and coordination nature, which, as the study demonstrates, render the current arm's length variant a random and inefficient standard, severely undermining the fulfilment of its roles. With a strong legal theory backbone, but a tax policy orientation, the study assesses both the time and space evolutions of the arm's length standard, establishing, therefore, the content of and limits to the arm's length core elements, based on which the proposed solutions are designed, respecting a feasibility framework of implementation, for short-term action.*

*Keywords: Arm's Length Standard, Transfer Pricing, Rational Business Conducts, Formula-Based Solutions, Simplification.*

*Tyrime siūloma naujai permąstyti ištiestosios rankos standartą (angl. arm's length standard), pateikiant tarpusavyje susietų sprendimų rinkinį, grindžiamą sistemingu racionalaus verslo elgesio principų ir formulėmis pagrįstų alternatyvų integravimu į esamą ištiestosios rankos standarto taikymo praktiką. Toks permąstymas yra būtinas siekiant spręsti pagrindinius iššūkius, susijusius su esminiais šio standarto elementais – jo logika, rezultatais, laikymosi reikalavimais, dalyvių vaidmenimis ir koordinavimo pobūdžiu. Kaip parodoma tyrime, dėl šių problemų dabartinė ištiestosios rankos standarto versija tampa atsitiktine ir neefektyvia sistema, reikšmingai silpninančia jos funkcijų įgyvendinimą. Remiantis tvirtu teisės teorijos pagrindu, tačiau orientuojantis į mokesčių politiką, tyrime analizuojama ištiestosios rankos standarto raida laiko ir erdvės aspektais. Tai leidžia nustatyti šio standarto esminių elementų turinį ir jų ribas, kurių pagrindu kuriami siūlomi sprendimai. Šie sprendimai parengti atsižvelgiant į jų įgyvendinimo galimybes ir yra skirti trumpalaikėms praktinėms priemonėms.*

*Raktiniai žodžiai: ištiestosios rankos standartas (Arm's Length Standard), sandorių kainodara (transfer pricing), racionalus verslo elgesys, formulėmis pagrįsti sprendimai, supaprastinimas.*

*O estudo propõe uma reimaginação do arm's length standard, apresentando uma série de soluções integradas, com base em uma sistemática introdução tanto de condutas racionais de negócios como de soluções baseadas em fórmulas para a praxis do arm's length standard. Esse esforço de reimaginação é necessário para o enfrentamento dos* *maiores desafios relacionados aos diferentes elementos constituintes do núcleo do arm's length standard, nomeadamente, rationale, resultados, requisitos formais (compliance), objetivos e natureza de coordenação que, conforme demonstrado pelo estudo, acabam por tornar o arm's length um standard randômico e ineficiente, o que severamente compromete o atingir dos seus objetivos. Com uma forte base jurídica, mas um olhar para a política fiscal, o estudo analisa a evolução do arm's length standard tanto em uma perspectiva temporal como espacial estabelecendo, portanto, o conteúdo e os limites dos elementos constitutivos do núcleo do arm's length, com base nos quais as soluções propostas são desenhadas, respeitando uma implementação nos moldes de uma feasibility framework, para uma aplicação em curto prazo.*

*Keywords: Arm's Length Standard, Preços de Transferência, Condutas Racionais de Negócios, Soluções Baseadas em Fórmulas, Simplificação.*

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A REIMAGINED ARM'S LENGTH STANDARD

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