Sigma TC's News

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Impact of VAT on year-end transfer pricing adjustments

Providing intra-group services to member companies presents a significant challenge for multinational enterprises, as they must align various systems of direct and indirect taxation (such as corporate income tax and transfer pricing for direct taxation, and VAT for indirect taxation). Each of these systems is complex on its own, and additional complexity arises when they start to overlap, requiring an assessment of whether indirect taxation (e.g., VAT) applies to certain adjustments based on direct taxation rules (e.g., transfer pricing rules).

This issue has long been a current problem in European VAT legislation, and the Court of Justice of the European Union (CJEU) is increasingly addressing questions related to VAT and transfer pricing.

In this context, an important question arises regarding which transactions are subject to VAT.

According to Article 2(1)(c) of the VAT Directive:
"*1. The following transactions shall be subject to VAT:*
...
(c) the supply of services for consideration within the territory of a Member State by a taxable person acting as such;"

While the term "supply of services for consideration" may seem clear outside the context of tax regulations, in VAT taxation, the question of "supply for consideration" is not so straightforward, as determining the existence of such a supply can led to complex debates that can easily evolve into uncertain interpretations.

The question of whether a transaction qualifies as a "supply of services for consideration" has been frequently examined in the context of VAT by the Court of Justice of the European Union (CJEU) in various situations (from street performers to rewards). This question is significant because determining whether a transaction is subject to VAT often hinges on whether the service was provided for consideration as defined by VAT regulation.

One of the key factors that the CJEU considers, besides the existence of the service and the consideration itself, is the direct link between the service and the payment made by the recipient to determine whether the transaction will be considered subject to VAT.

In the case of "supply of services for consideration," this is a concept in European VAT legislation for which member states are not left with the discretion to interpret according to their judgment. However, in practice, problems arise in interpreting this term, and incorrect conclusions about the (non)existence of "supply of services for consideration" by national tax authorities and courts lead to various proceedings before the Court of Justice of the European Union, in order to ensure the uniform application of EU law in the VAT area.

On 3rd April 2025, the Advocate General of the CJEU, Jean Richard de la Tour, delivered his opinion in the case SC Arcomet Towercranes SRL, C-726/23, in which, among other things, the issue was raised as to whether Article 2(1)(c) of the VAT Directive should be interpreted to mean that amounts invoiced by the parent company, which assumes business risks, to its subsidiary in another Member State using the method recommended by the OECD Transfer Pricing Guidelines (in this case, the transactional net margin method) **can be considered as remuneration for a supply of services for consideration covered by the scope of the VAT Directive.**

The facts in case C-726/23 are as follows: the company SC Arcomet Towercranes SRL (Arcomet Romania) is part of the global Arcomet group, which is engaged in the crane rental business. Arcomet Romania purchases or rents cranes to sell or lease them to its customers, while Arcomet Service NV Belgium (Arcomet Belgium) seeks suppliers and negotiates contract terms for its subsidiaries, including Arcomet Romania. Although sales and rental contracts are concluded between Arcomet Romania and its suppliers and clients, a transfer pricing study from 2010 showed that subsidiaries should generate operating profit within the range from -0.71% to 2.74%. The operating profit was based on the transactional net margin method, as provided in the OECD Transfer Pricing Guidelines, and was supported by transfer

pricing documentation. Based on this, a contract was concluded between Arcomet Belgium and Arcomet Romania, under which Arcomet Romania was guaranteed an operating margin within the specified range, while Arcomet Belgium was required to issue an invoice for the annual price adjustment if there was a profit exceeding 2.74%, or conversely, Arcomet Romania if the operating loss fell below -0.71%.

During the relevant years, an excess profit was recorded compared to the forecasted range, and Arcomet Romania received three invoices for the annual transfer pricing adjustment from Arcomet Belgium, in accordance with their contract, which defined their responsibilities and applicable transfer pricing policy. The invoices were reported as the provision of services within the EU.

In case C-726/23, among other things, the question arose **whether the transfer pricing adjustments**, as issued by Arcomet Belgium, **constitute a consideration for services** provided by Arcomet Belgium to Arcomet Romania.

In his opinion, the Advocate General emphasizes that this is a complex issue for several reasons:

1. The OECD Guidelines were designed for direct taxation purposes, which significantly differ from indirect taxation such as VAT.
2. The OECD Guidelines propose various methods for determining whether business relations between affiliated entities are contracted at market prices (e.g., the comparable uncontrolled price method, the resale price method, the cost-plus method, the transactional profit split method, and the transactional net margin method). Additionally, as pointed out by the VAT Committee, there are different types of transfer pricing adjustments (e.g., adjustments made by tax authorities) and other adjustments voluntarily made by taxpayers, meaning that each case needs to be approached individually.
3. VAT taxation is based on the economic and business reality of situations; therefore, it is necessary to examine each case individually to determine whether it meets the conditions for the application of the VAT Directive.

In considering the response to the question of the application of the VAT Directive to transfer pricing, the independent advocate states the following:

- A supply of services is carried out for consideration within the meaning of this provision if there is a **legal relationship** between the recipient and the provider of services in which mutual benefits are exchanged, and the consideration constitutes a real countervalue for the service provided. This is the case when there is a direct link between the service and the consideration. In this case, there was an agreement between the parties under which each party was obliged to perform certain services for the benefit of the other, thus a legal relationship existed. The Belgian company had certain tasks to perform and also bore the economic risks associated with the operational company. The agreement also provided for a consideration that ensured that the operational profit of the Romanian company remained within the agreed profit range, meaning that the contract includes both a service and a consideration.
- The remaining issue is to clarify whether a **determinable service** was provided to Arcomet Romania and whether there is a direct link between that service and the consideration received. Regarding the determinability of the service, it seems that this condition is met because Arcomet Belgium was responsible for negotiating the terms of the contract that Arcomet Romania would conclude. As for the direct link, the issue becomes somewhat more sensitive due to the provisions concerning the consideration, as any operating profit exceeding 2,74% must be paid to Arcomet Belgium. However, the ECJ consistently rules that the amount of consideration is not decisive, and that the direct link is not conditioned on the manner in which the consideration is set (e.g., lump sum). Therefore, the Advocate General believes that the same reasoning can be applied in this case because, although the amount of the consideration is not predetermined, the terms of the consideration are clearly defined in the contract with precise criteria and, as such, are not risky. The consideration for the services provided by Arcomet Belgium to Arcomet Romania can therefore be considered determinable from the moment the contract is concluded. The fact that the Romanian company must issue an invoice when the margin falls below -0,71% does not change this analysis, as such a margin is unlikely given that the range is set based on the arm's length principle. Additionally, the services provided by Arcomet Belgium, which are customary within the group’s relations, impact the margin of Arcomet Romania through savings that

enable the improvement of services to the end customers.

In light of the above, the General Advocate suggests that the answer to the question regarding the application of the VAT Directive to transfer pricing should be that transfer pricing adjustments, agreed upon within the framework of intra-group services and calculated using the method recommended in the OECD Guidelines, **may be considered a relevant consideration for VAT if they are directly linked to the services provided.**

Although the opinion of the Advocate General is not binding on the European Court of Justice (ECJ) nor must the Court follow it, it is not illogical, and it remains to be seen what decision the ECJ will make in this case, as well as in other cases dealing with VAT and transfer pricing issues. Therefore, taxpayers are advised to consider the VAT aspects of their group's transfer pricing policies. drugim predmetima koji se bave pitanjima PDV-a i transfernih cijena. Poreznim obveznicima se stoga savjetuje da razmotre PDV aspekte politika transfernih cijena svoje grupe.

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