

# Assess OR tax rules in advance and save money

**The implementation of REACH is challenging to manufacturers and importers preparing for registration, especially for non-EU-based manufacturers having to appoint an Only Representative (OR). An often overlooked but crucial aspect of OR operation is their taxation. Astrid Pieron and Charles-Albert Helleputte advise.**

The appointment of an Only Representative has been one of the priorities of non-EU-based manufacturers. But have they considered the taxation aspects of the OR's activity – particularly for 'intra-group ORs'? Indeed, moving functions and risks within a multinational group should be closely monitored from a transfer pricing point of view. Mayer Brown obtained the first tax ruling on that matter in Belgium at the end of April.

## What is transfer pricing?

Transfer pricing rules aim to measure related-party transactions against the "arm's length standard".

This is the benchmark for reviewing whether a related party transaction can be 'accepted' by tax authorities. In Europe, the OECD transfer pricing guidelines inspire most of local tax legislation or tax administrative practices, providing for some level of convergence.

Tax authorities review whether there is any (unjustified) shift of income and profits outside of their territory resulting in lower tax revenues. A transfer pricing review by income tax authorities will generally not take place on a single transaction but will cover an aggregated set of transactions within a specific tax year. The adjustments might take place years after the fact and it can be costly. Therefore, planning and monitoring transfer pricing issues will save money.

## Transfer pricing for intra-group ORs

It is common for a multinational group with non-EU based producers to appoint one of their European affiliates to act as its REACH OR. Various reasons can justify keeping the OR function 'in-house' rather

than appointing one of the many third-party suppliers offering OR services, but awareness of the business and trust in people are probably the key drivers.

There are two main transfer pricing aspects when appointing an affiliate as OR:

- \* how to properly price the risks and functions assumed by the OR and
- \* how does this new task impact existing transfer pricing policy? Both could have important consequences on the final tax bill.

## How to value the OR function?

Finding internal or external comparables for uncontrolled price, one of the most accurate valuation methods proposed by the OECD guidelines, is difficult. Intra-group ORs typically only act for company(ies) of the group; they do not offer their OR services to third parties, nor does the non-EU principal use third-party OR suppliers. Moreover, OR services provided by third-party suppliers could be very different from those rendered by intra-group ORs: Third-party ORs provide services 'à la carte' for a very large and disparate set of substances while intra-group ORs may have more focus and, as a result, more insight, on *ad hoc* substances.

Therefore, other methods, based on 'net margin', are typically used for testing the arm's length price of the function performed by the OR. In the absence of clear guidance as to the net margin to be realised for OR services, companies are likely to perform an economic study, called 'functional analysis', to help them to find comparable companies assuming 'equivalent' risks and thereby define the arm's length range. The OR agreement will be key in determining the risks and functions it assumes.

## Existing transfer pricing policies and PE risks

Adding OR services to the set of functions performed by an affiliate company is likely to affect the transfer pricing policy of the group.

Particular attention should be paid to avoid the provision of such services endangering existing transfer pricing policies established, for example, for toll manufacturing arrangements. Moreover, the risk of creating a taxable presence (permanent establishment or "PE") of the non-EU principal in the country of the OR should be closely monitored, especially in the light of new trends in PE such as 'service' or 'agency' PE.

## Belgian ruling

It is essential to be certain about the tax framework for your OR's activity. Our preferred approach is to obtain a confirmation of the arm's length character of the remuneration from the tax authorities. This can be done by seeking an 'advance pricing agreement' – an arrangement "before the fact" that determines an appropriate set of criteria such as method and comparables for the determination of the transfer pricing of OR services over a fixed period of time.

In Belgium, we obtained the first transfer pricing ruling addressing the method to be used for computing arm's length pricing for OR services and securing a reduced taxable basis for the OR.

This ruling has also been an opportunity to obtain a validation of the VAT treatment to be given to the different services performed by the OR for its foreign principal, avoiding any VAT pre-financing costs.

Taxes do matter!

## For further information contact Mayer Brown

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Mayer Brown is a global law firm with extensive experience in the field of chemicals regulation.



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