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“Back to the future?” – Belgian Court rules that DEMPE concept cannot be applied retroactively

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In a recent judgement[1], the Belgian Court of Appeal of Ghent ruled in favour of the taxpayer as regards a transfer pricing case in relation to intangibles. Even though the case is complex with a number of factual and procedural twists, the Court made a number of explicit and noteworthy statements on whether or not the OECD Transfer Pricing Guidelines (“TPG”) can be applied in an ambulatory way while interpreting and enforcing the arm’s length principle.

Background and decision

The case is a transfer pricing dispute for financial year 2009.

Referring to the 2017 version of the OECD TPG, the Belgian tax administration claimed that the Belgian entity carried out the development, enhancement, maintenance, protection, and exploitation (“DEMPE”) with respect to the license activity of a foreign related company[2]. Therefore, based on article 26 of the Belgian Income Tax Code (“BITC”) and article 9 of the Double Tax Treaty[3] (“DTT”), the tax administration claimed that for financial year 2009, the revenue of the Belgian entity must be increased by the royalties (less related costs) received by the foreign related company from its licensees.

The taxpayer argued, as part of its broader defence, that the Belgian tax authorities are not allowed to retroactively apply the DEMPE concept.

The Court of Appeal stated that for the application of articles 26 BITC and 9 DTT, the tax administration has to prove by means of a functional analysis whether an abnormal or benevolent advantage was granted by the taxpayer. According to the Court, the most recent version of the OECD TPG may be used only to the extent that it provides useful clarifications without broadening the scope of the guidelines. The guidelines in relation to the DEMPE concept and those relating to hard-to-value intangibles have only been elaborated in 2017 OECD TPG. Therefore, in the case at hand, only the 1995 OECD TPG were considered relevant for assessing the arm’s length character of transactions in 2009.

Moreover, the Court equally noted that Belgian tax administration failed in its burden of proof.

Indeed, according to the judge the tax administration did not substantiate their position with a comparability study and stated that it was not proven that the relevant functions were indeed performed in Belgium as opposed to the location where the IP was held. The lack of burden of proof is something the authors also have observed in a number of other transfer pricing cases brought before Belgian courts[4].

Reasoning of the Court of Appeal of Ghent

First, the Court of Appeal of Ghent stated in its judgement of 8 June 2021 that the OECD TPG do not have a direct effect in Belgium and are merely used as a starting point in transfer pricing analysis.

In addition, the Court notes that the facts relate to the financial year 2009 and that only the economical context and legal framework of that time should be taken into account. The Court continues by stating that the tax assessment was partly based on the 2017 version of the TPG whereas the only guidelines that were available at the time of the transactions were the 1995 TPG. In this respect, the Court of Appeal of Ghent ruled that the tax authorities can issue a tax assessment on more recent versions of the TPG, but only if the new provisions are a mere clarification of existing guidelines, without broadening the scope or imposing new (more stringent) guidelines.

In order to dismiss the application of the 2017 OECD TPG, the Court of Appeal of Ghent referred to two other elements

- the Belgian TP circular[1], embedding the 2017 TPG, which states that "*the provisions of this circular shall apply to intercompany transactions as from 1 January 2018. Therefore, with respect to intercompany transactions occurring prior to this date, the taxpayer and the tax administration will be able to rely on the consultative documents, including international rules, into force at that time*"[5]; and
- the Amazon case[6], in which the General Court recognised that the European Commission infringed the principle of legal certainty by stating that *"it must be held that the Commission was entitled to base its findings concerning the existence of an advantage on the guidelines – which are, moreover, merely a non-binding tool – set out in the 1995 OECD Guidelines. However, in so far as the Commission relied on the 2010 version of the OECD Guidelines, that version is not relevant, unless it merely provides a useful clarification, without further elaboration, of the guidelines already set out in 1995. As for the 2017 version of the OECD Guidelines, since they were published after the relevant period and in so far as the recommendations contained therein have evolved significantly in relation to the 1995 version of the OECD Guidelines, those guidelines are not relevant in the present case. In particular, the DEMPE functional analysis method cannot be regarded as relevant from a temporal point of view, in the present case, since it is a tool which was set out only in the 2017 version of the OECD Guidelines".*

State of play

The non-retroactive application of the law is not an overriding principle under Belgian legal framework[7]. The Belgian Courts accept numerous exceptions (e.g. compelling financial interests of the State), especially in tax matters[8].

Interpretative laws that merely provide a useful clarification, without further elaboration could

apply to events that took place prior to their enactment. The same logic applies to soft law – such as administrative circular letters – to the extent that they do not:

- add general rules to the current legal framework;
- intend to be mandatory; and
- provide for any means to ensuring their enforcement[9].

In the author's opinion, there are clear arguments based on the principle of legal certainty to set aside more recent versions of the OECD TPG endorsed after the taxable event when they go beyond mere useful.

In this respect, it is interesting to note that in a recent non-TP related case[10], the Supreme Court acknowledged that the principle of legal certainty provided by article 1 of the First Protocol to European Convention on Human Rights prevails on the principle of tax legality.

Conclusion

The fundamental principle of legal certainty allows to assess the arm's length character of intercompany transactions in the light of the OECD TPG in force at the time of the taxable event and to consider subsequent versions if, and only if, they are in the nature of a mere clarification, without broadening the scope or imposing new (more stringent) guidelines. In this respect, the Court of Appeal of Ghent considered the DEMPE concept not to be a mere clarification and hence it cannot be applied retroactively.

The tax administration may still appeal this case before the Supreme Court and challenge the reasoning of the Court of Appeal of Ghent from a legal perspective.

[1] Ghent, 2016/AR/455, 8 June 2021

[2] Incorporated in Ireland and with its place of management in Luxembourg since October 2007.

[3] Convention between Belgium and Luxembourg for the avoidance of double taxation and the regulation of certain other questions relating to taxes on income and capital, dd. 17 Sep. 1970.

[4] Antwerp, 2017/AR/1640, 5 March 2019; Gent, 8 June 2021, 2016/AR/455

[5] paragraph 284 of the Circular 2020/C/35 dd. 25 February 2020.

[6] General Court (Seventh Chamber, Extended Composition), Grand Duchy of Luxembourg vs. European Commission, 12 May 2021, T?816/17 and T?318/18, §§ 154-155.

[7] Article 2 of the Belgian Civil Code.

[8] Constitutional Court, n° 177/2005, dd. 7 December 2005; Constitutional Court, n° 109/2004, dd. 23 June 2004; Constitutional Court, n° 36/2000, dd. 29 March 2000; Constitutional Court, n° 45/2001, dd. 8 April 2001.

[9] Council of State, *F.J.F.*, 2018/273, 20 June 2018; Council of State, n° 72.369, dd. 11 March 1998; Ghent, *F.J.F.*, 96/110, 14 March 1996; Supreme Court, *F.J.F.,* 98/91, 19 February 1998.

[10] Supreme Court, n° F.20.0049.N, dd. 4 June 2021.

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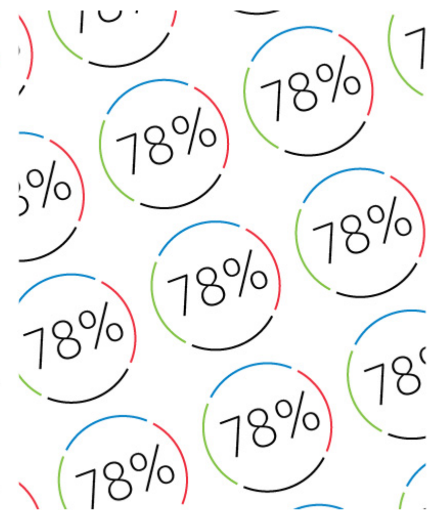

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