

ESCURA

A close-up photograph of three yellow pencils in a white cup. The pencils are sharpened and their tips are visible. The background is a soft, out-of-focus yellow and white. The text 'ESCURA' is in the top left, and 'TRANSFER PRICING' is in a white box at the bottom center.

**TRANSFER  
PRICING**



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## ÍNDICE

- I. Introduction
- II. What is Transfer pricing?
- III. Who is required to prepare the Documentation?
- IV. Comparative Law.
- V. Basic Principles.
- VI. Legislation.
- VII. Most significant aspects.
- VIII. Which are the related entities?
- IX. Obligations of the taxpayer.
- X. Determination of normal market value.
- XI. Methodology.
- XII. Requirements for cost-sharing arrangements.
- XIII. Documentation requirements.
- XIV. Sanctioning Regime.
- XV. Binding Consultations.
- XVI. BEPS Project.





## I. INTRODUCTION

“The regulations establish the taxpayer's obligation to value all the operations carried out with related entities or persons to the value of market”

The rules on transfer pricing originate in the OECD Directive and have been developed in different countries of the European Union with the consequent implementation in each of the countries.

The regulations on related-party transactions seek to prevent the use of prices other than normal market prices to prevent income from one entity to another which, as a general rule, has the practical effect of reducing or deferring the taxation of the income tax payable by the parties affected by the related party. At the international level, although the use of transfer pricing does not reduce the tax burden on all parties, these rules are necessary to prevent the movement of resources from one country to another.

The guiding principle of the rules governing such transactions is that the price to be paid within the relations between the different companies belonging to a group should be the price fixed under normal conditions between independent parties, or in other words, according to market value. This principle gives tax administrations the right to adjust transfer prices as soon as they occur between independent parties.

The basis of this regulation is the so-called 'Full Competition Principle' which essentially seeks to determine what the price of the transaction or the margins obtained by the parties would have been if all their transactions had been carried out within a competitive market, i.e. as if the transaction had been carried out with or between independent parties.

The majority of European Union and therefore Spanish legislation fiscales establishes special valuation rules for analyzing and valuing intergroup transactions. And the guiding principle is the one mentioned above, i.e. set between independent parties.

## II. WHAT IS MEANT BY TRANSFER PRICING?

“The regulation applies to all companies with independence from its size.”



- **Definition:**

These are transactions between entities in the same group, i.e. related entities that must be valued at market value.

- **Market Value:**

Market value shall be understood to be that which would have been agreed by independent persons or entities under conditions of free competition.

- **Administrative Capacity:**

The Tax Authorities may verify that transactions between related parties have been valued at market value and shall make the appropriate valuation adjustments. Special emphasis of the concept of management capacity.

- **Does transfer pricing regulation affect all companies?**

Yes, no matter their size.

- **Are all companies required to document them?**

No. However, the valuation must be justified.

- **Even if there is documentation of related-party transactions, can there be a penalty?**

Yes, although there is freedom in the documentation, it must have a technical and expert content in the field of related-party transactions.

- **If there is no documentation, apart from the reversal of the burden of proof of the price charged, can I be sanctioned?**

Yes. 1,000 euros per data set and 10,000 euros per data set.

- **If there is documentation, what kind of sanction exists for providing inaccurate or false documents?**

Firstly, if there is documentation, it is the Administration that has to contradict the price applied and the penalty is:

For each piece of information 1,000 euros and 10,000 euros per set of data.

- **In which model should related-party transactions be reported?**

As a novelty in 2017, related-party transactions over €250,000 must be reported on form 232, which is presented each year in November.

- **Can the Tax Administration be asked to determine the valuation of related-party transactions carried out prior to their execution?**

Yes, it will be valid for a period of 4 years.

- **Who is required to document?**

The companies that have operations related to the same entity and that exceed the amount of 250,000 €

- **A company carries out several operations with the related entity; should the limit of 250,000€ be taken into account for each of the individual or joint operations?**

The documentation obligation is established at a joint level and by related entity.



### III. WHO HAS THE OBLIGATION TO PREPARE THE DOCUMENTATION?

“Those entities that carry out operations between related entities that exceed €250,000 have the obligation to prepare the documentation.”

Companies are required to prepare documentation if they:

- A) Carry out transactions between related companies that exceed the amount of €250,000 in the tax period with the same related company or person.
- B) No matter the size of the company.
- C) Regardless of the internal or international nature of the operation.

**Documentation is not required**, of both the group and the obligor:

- A) Transactions between entities in the same group that are taxed on fiscal consolidation.
- B) Those carried out with its members by Economic Interest Groupings and Temporary Business Associations.
- C) Those made in the context of takeover bids or takeover bids for securities.



## IV. COMPARATIVE LAW

“The rules on related-party transactions seek to prevent the transfer of income from one entity to another through the use of prices other than the market prices.”

- **Transfer Pricing Guidelines of 1995** with successive updates. Latest version of July 2010. OECD Guidelines Directive.
- The rules on related-party transactions seek to prevent the use of prices other than the normal market price from being used by **transferred income from one entity to another** which, as a general rule, has the practical effect of **reducing or deferring the taxation of the IS** corresponding to the parties affected by the relationship.
- At the international level, these standards are necessary to prevent the movement of public resources from one country to another. We are finding that the subsidiaries/branches of foreign parents are subject to such regulations and therefore, in foreign companies are being implemented as mandatory transfer pricing regulations.
- **At the international level:**
  - The OECD Guidelines July 2010
  - The European Transfer Pricing Forum
  - Local legislations of the countries
- **At the Spanish level:**
  - The Corporate Tax Act
  - Corporate Income Tax Regulations
  - The Rules of Friendly Procedure
  - Jurisprudence



## V. BASIC PRINCIPLES

“Penalties may be for lack of documentation, for inaccurate documentation or for value correction.”



- **Principle of free competition** (market value):

“Where the two (related) companies are, in their business or financial relations, bound by conditions accepted or imposed which differ from the ones that would have been agreed by independent companies, the profits which would have been obtained by one of the companies in the absence of such conditions, and which in fact have not been made because of them, may be included in the benefits of that company and subject to taxation accordingly.” [Art.9.1. Model Double Taxation Convention OECD](#)

“Transactions between related persons or entities shall be valued at their normal market value. Normal market value shall be understood as that which would have been agreed by independent persons or entities under conditions of free competition.” [Art.18.1.LIS](#)

- **Burden of proof on the taxpayer:** this type of transaction reverses the burden of proof on the taxpayer.

- **Obligation to document operations**

- **Methodology:** 5 different methods:

- Comparable Free Price (CUP)
- Resale Price
- Increased Cost (Cost Plus)
- Net Margin (NMT)
- Distribution of Profit (Profit Split)

- **Penalty regime:** is sanctioned for lack of documentation, inaccurate documentation or valuation correction.

## VI. LEGISLATION

- OECD Guidelines 1979, modifications of 1995
- RD 897/2001, of the 9<sup>th</sup> of July, by which the Corporate Income Tax Regulation, approved by RD 1777/2004, of 30 July, on matters relating to documentation obligations for related-party of linked transactions.
- RD 1793/2008, of the 3rd of November, modification of the Corporate Income Tax Regulations.
- Law 27/2014, of the 27th of November, on Corporate Tax.
- Royal Decree 634/2015, of 10 July, approving the Corporate Income Tax Regulations.



## VII. MOST SIGNIFICANT ASPECTS



- Simplify the documentation for those entities or groups of entities whose net turnover is less than 45 million euros.
- The perimeter of the linkage in the social-company sphere is restricted, and stays at a 25% stake (previously it was 5% or 1% for listed companies).
- The **hierarchy of methods contained in the previous regulation for determining the market value of related-party transactions is eliminated**, and other methods and techniques of economic valuation are also permitted in the alternative, provided that they comply with the Principle of Free Competition.
- Included is the **modification of the sanctioning regime** that is less burdensome: pecuniary **fix fine of 1,000 euros per piece of data and 10,000 euros** per set of data, omitted or false.
- The remuneration paid by an entity to its **directors and managers for the performance** of these functions is no longer considered to be related-party transactions.
- The cases of linkage are eliminated (i) one non-resident entity in Spanish territory and its permanent establishments in said territory; (ii) and two entities in a fiscal group of cooperatives.
- The **operations of the partners with the professional societies** will be valued according to methods adjusted to the economic reality. The limit for not having to value the services of members of professional societies is reduced from 85% to 75% of the result, prior to the deduction of the remuneration of professional members.
- In the case of Spanish entities with a **permanent establishment** abroad, when the double taxation agreement is applicable, the estimated income from internal transactions carried out with the permanent establishment, valued at market value, will be included in the tax base.

**\*For those entities that meet the requirements on turnover of small companies, this specific documentation can be understood to be completed through a standard document prepared by the Minister of Finance.**

- ◆ With effect from 1 January 2015, it is expressly stated in the regulatory text that the market value of the transactions will be determined on the basis of the following parameters:
- ◆ The nature of the transaction and the conduct of the parties.
- ◆ The business strategy and/or any other circumstance that is relevant and on which the taxpayer may have had information.

The legislator has introduced **3 categories of documentation**, depending on the amount of the Group's turnover to which the taxpayer belongs:

- ◆ Country-by-country report.
- ◆ General regime
- ◆ Regime abridged





## VIII. WHICH ARE THE LINKED ENTITIES?

“Article 18.2 of the Corporate Income Tax Law establishes the type of entities that are considered linked.”

### LINKED TRANSACTIONS (article 18.2 LIS)

- An entity and its partners and participants (the participation must be equal to or greater than 25%, before 1-01-2015 the participation was 5%).
- An entity and its directors or administrators.
- An entity and spouses or persons related by family, partners or participants, directors or administrators.
- Two entities belonging to a group (article 42 of the Commercial Code).
- An entity and the directors or administrators of another entity, when both belong to a group.
- An entity and spouses or persons connected by family relationships of partners or members of another entity when both companies belong to a group.
- An entity and another entity in which the former indirectly holds at least 25% of the share capital or equity capital.
- Two entities in which the same shareholders or participants or their spouses, or persons related by kinship, have a direct or indirect interest in at least 25% of the share capital or own funds.
- An entity resident in Spanish territory and its permanent establishments abroad.

### IX. TAXPAYER OBLIGATIONS

“La principal obligación será determinar si el precio de las operaciones vinculadas está a valor normal de mercado.”

The main obligation of taxpayers will be to determine the price of their related-party transactions based on the normal market value; in this case, it is the taxpayer who has the burden of proof.

In addition, taxpayers must prepare the documentation that supports the correct application of the principle of full competition, taking into account the complexity and volume of transactions.

	Fiscal years ended as of 19/02/2009	Fiscal years closed as of 01/01/2015
Burden of proof	Contributor	Contributor
Documentation requirements	Yes, in accordance with Royal Decree 1793/2008	Yes, in accordance with Royal Decree 1793/2008 and RD 634/2015.
Penalty regime	New sanctions regime	Modification of the sanctioning regime



## X. DETERMINATION OF NORMAL MARKET VALUE

They must be compared:

- circumstances of transactions between related parties.
- with circumstances of transactions between comparable independent persons or entities.

Transactions are considered comparable when there are no differences between the two (price of the good or service, margin of the transaction).

Comparability analysis may also be carried out even if differences exist (if they can be eliminated with appropriate corrections).





## XI. METHODOLOGY

“There are different valuation methods, some based on price and others based on the profit.”

### 1. COMPARABILITY ANALYSIS

The following circumstances will be taken into account:

1. Characteristics of the goods or services
2. Functions performed by each party
3. Risks assumed by each party
4. Contractual terms
5. Characteristics of the market
6. Business Strategies

Any absence of comparable transactions and the lack of consideration of any of the circumstances should be reported to be justified.

### 2. VALUATION METHODS

1. **Comparable uncontrolled price** method of the comparable free price.
2. The **cost-plus** method
3. **Resale price** method' resale price

#### Methods based on the profit:

1. Method of the distribution of the result “**profit split**”.
2. Método del margen neto del conjunto de operaciones “**transactional net margin**”



### 3. WHAT ARE THE VALUATION METHODS?

1. "**Comparable uncontrolled price**" comparable free price method: a method of comparing the price of the goods or services transferred in an operation linked to the price of the goods or services transferred in the framework of an unrelated transaction.

Does it apply in reality?

- Rentals
- Interest on loans
- Commissions for intermediation
- Royalties

2. **The cost-plus method:** The cost-plus method consists of comparing the margin on direct and indirect costs incurred in the supply of goods or services in a related operation with the margin on direct and indirect costs incurred in the supply of goods or services in a non-related operation.

3. **Resale price method 'resale price':** The resale price method consists of comparing the resale margin obtained by the buyer of an asset (acquired in a related transaction) when reselling the asset in the context of an unrelated transaction with the resale margin obtained in unrelated purchase and resale transactions.

4. **Net operating margin method (NMEC):** The fixed net operating margin method based on an appropriate denominator (e.g. costs, sales, etc.) obtained by a company in the context of a related-party transaction with the fixed net operating margin based on the same denominator obtained in the margin of an unrelated transaction.

5. **Método del reparto del Beneficio (Profit Split):** The method of allocation of profit consists of attributing to each associated undertaking participating in a related-party transaction the part of profit or loss generated by that transaction that an independent undertaking would expect to make in the context of a comparable, unrelated transaction.



## XII. REQUIREMENTS OF COST-SHARING AGREEMENTS

They should include, among other information:

1. Identification of the other participants,
2. Scope of activities and projects,
3. Duration,
4. Criteria for quantify the distribution of expected profits, etc.



### XIII. DOCUMENTATION REQUIREMENTS

- Requirements from **19/02/2009**.
- The documentation must be at the disposal of the Tax Administration as of the end of the voluntary period for filing or settling Corporate Income Tax returns.
- Auditors special incidence.
- The documentation shall refer to the tax or settlement period in which the related-party transactions are carried out.

#### 1. GROUP'S DOCUMENTATION (art.19 RIS)

1. General description of the group.
2. Identification of the group's entities (linkage map).
3. Description of the nature, amounts and flows of related-party transactions.
4. Description of functions and risks.
5. Ownership of intangible assets.
6. P 1. Transfer pricing policy, method of fastening of prices.
7. Cost-sharing agreements and service contracts.
8. Prior valuation agreements or mutual agreement procedures.
9. Group report or equivalent annual report.



## 2. DOCUMENTATION OF THE TAX LIABLE PARTY (art.20 RIS)

1. Fiscal data of entities with which related-party transactions are carried out.
2. Comparability analysis.
3. Method of valuation chosen, justification, application form and the stipulation of the security or securities intervals.
4. Criteria for the distribution of services provided and cost-sharing arrangements.
5. Any other information, shareholders' agreements.



## XIV. SANCTIONING REGIME

“The imposition of sanctions in this area of transfer pricing is linked to the lack of documentation or incomplete documentation.”

The imposition of transfer pricing penalties is linked to the lack of correct, incomplete, inaccurate or false documentation. Specifically, the penalty regime for the case that there is no adjustment for missing or false data is €10,000 (previously €15,000); and €1,000 for missing or false data (previously €1,500).

In the event of a value adjustment, the penalty is calculated based on 15% of the adjusted amount, as detailed in the following tables:

	Tax Administration	Sanction
Proper documentation	- No value adjustment: - Value adjustment:	No sanction. No sanction.
Lack of incomplete, inaccurate or false documentation or documentation	- No value adjustment:	- 1.000€ per data or - 10.000€ per data set. Limit.
	- Value adjustment:	- 15% of adjustment.

### RELATIONSHIP BETWEEN THE INFRINGEMENTS AND THE PENALTIES PROVIDED FOR IN ARTICLE 18.13 OF THE LIS:



INFRACTIONS	SANCTIONS
Non-compliance of documents without value adjustment	Fixed financial penalty
Documentary non-compliance with value adjustment	Percentage pecuniary fine
Declaration of a market value other than that derived from the documentation	Percentage pecuniary fine

## XV. BINDING CONSULTATIONS

Due to the difficult interpretation of the legislation in force for its correct application to a specific transfer pricing case, the Directorate General of Taxes issues a reply to the different queries posed by taxpayers that clarify the different particularities of each case. In this regard, we highlight the following binding consultations:

- Binding consultation V1263-11 of 20 May on **loans between related entities.**
- Binding consultation V1787-12 of 14 September on **credit policy agreement.**
- Binding consultation V2402-10 of 10 November on **renting a house to a related person.**
- Binding consultation V0249-08 of 7 February on **entities taxed in fiscal consolidation.**
- Binding consultation V0517-07 of 13 March on **operations with UTE (joint venture).**
- Binding consultation V1567-09 of 30 June on **obligation to document related-party transactions.**
- Binding consultation V2022-09 of 15 September on **the transfer of shares to the company itself.**
- Binding consultation V0454-10 of 10 March on **the form of organization of the documentation.**
- Resolution NUM. 2296/2012 of the Central Economic Administrative Tribunal on **the use of comparable secrets by the Tax Administration.**
- Resolution NUM. 44/2010 of the Central Economic and Administrative Court **management support services between related parties.**
- Binding consultation V1153-12 of 28 May on the **deduction of expenses incurred in the organization of advertising events.**
- Binding consultation V1044-10 of 18 May on **deduction of expenses incurred in R&D.**



You can access the binding queries on our blog:

<http://www.escura.com/blog-escura/category/precios-de-transferencia/>

## XVI. BEPS PROJECT

The **BEPS project** (Base Erosion and Profit Shifting) is a very ambitious project of the OECD together with the G20, which entered into force on February 28, 2016; it aims to **regulate the aggressive fiscal planification of multinationals in order to reduce their tax burden.**

The BEPS project is based on 15 actions which are 15 measures developed to control the problem of tax evasion and the aggressive fiscal planification by multinationals.

These actions can be broken down into 5 large blocks:

- Actions 2 to 5 seek to develop that all business operations should be consistent and free of inconsistency.
- Actions 6 through 10 deal with the substance. There cannot be transaction without substance.
- Actions 11 to 14 focus on transparency. Groups should be transparent in what they do and explain it to management.
- Action 1, dealing with the digital economy. Electronic commercial transactions must be taxed at the place of consumption. Adaptation of the rules.
- Action 15 develops international tax transparency.

The BEPS project aims to make taxation fairer and in this way transactions between related companies pay their taxes where they have actually been carried out.



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