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Research Paper

Arbitration Decisions on Transfer Pricing: A Trend Favoring Taxpayers?

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ABSTRACT

This study aims to analyse the transfer pricing practiced by related entities. This matter has special relevance due to the nature of the transactions and all the problems related to tax litigation in this matter. The empirical study carried out on tax disputes in the area of transfer pricing in Portugal reveals that the vast majority of the74 arbitration decisions issued between 2012 and 2024 are favorable to taxpayers. To carry out this work, we intend to understand the evolution of the decisions of the Arbitration Court of the Administrative Arbitration Center (CAAD) with a view to assessing the possible occurrences of erosion of the tax base. Therefore, we present a qualitative approach based on the study of arbitration case law, taking into account the growing tendency of taxpayers to resort to arbitration to resolve disputes. In this study, we analysed the arbitration decisions and concluded that in all 74 arbitration decisions, between October 2012 and August 2024, the operations most contested by the Tax and Customs Authority (AT) are financial operations and transactions of goods between related companies. Most of the decisions favorable to the taxable person are related to the principle of comparability of interconnected transactions, the methodology used to determine transfer prices, the legal assumptions applicable to intra-group transactions, and the intervention of jurisdictions with more favorable tax regimes. This study is limited to case law from 2012 to 2024 by arbitral tribunals. It does not take into account case law from other courts and countries, which could have resulted in different conclusions regarding transfer pricing decisions. There are also limitations resulting from the applicability of the arm's length principle and comparability, as well as the complexity of transfer pricing, which involves multidisciplinary concepts and requires a subjective analysis of comparability between operations.

Keywords: Related Entities, Transfer Pricing, OECD, Arbitral Tribunals

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1. INTRODUCTION

This study aims to analyze tax disputes arising from transfer pricing practices among related entities. This subject is particularly relevant given the nature of the transactions, especially those carried out by multinational companies, and the problems associated with arbitral tax litigation. Arbitral tribunals have ruled on several tax disputes regarding transfer pricing.

Transfer pricing plays a key role for multinational companies that aim to maximise their profits by relocating their income to tax-privileged countries or territories. It is not just an accounting technique for measuring costs, but also a strategic method for allocating resources and for tax planning to obtain a greater market share.

It is interesting to analyse how the decisions of the CAAD (Centre for Administrative Arbitration) prevent tax erosion through transfer pricing. The Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, published for the first time in 1995 by the OECD, guide transfer pricing (Cools et al., 2008). The voluntary adoption of the OECD Guidelines represents a consistent path with regard to the need for international harmonisation of tax legislation.

The abundant literature on this subject provides a delimitation of the transfer pricing regime, of the general principles underlying transfer pricing, of the pricing methods (traditional and non-traditional), and also, indirectly, of the tax evasion and tax planning. All the existing literature also provides a better understanding of the motivations of companies in attempting to manipulate transfer prices and tax evasion, taking into account the OECD Guidelines on transfer pricing and the tax legislation in force.

In order to better understand this transfer pricing regime, an empirical study was carried out to analyse the decisions of the Arbitration Courts (AT), taking into account the principle of comparability of transactions, the pricing methods, and the applicable legal assumptions.

2. LITERATURE REVIEW

Multinational companies have used transfer pricing to minimise their tax burden, according to Lin and Chang (2010). According to these authors, the strategy adopted consists of undervaluing goods and services from countries with a high level of taxation and overvaluing them in countries with lower tax rates. This objective of minimising the tax burden can be achieved through various

strategies, according to Zinn and Riedel (2014), such as in the case of intra-group financing at an artificial interest rate; or in the case of centralisation of functions in which corporate functions are transferred to low-tax jurisdictions; or when the prices of intra-group goods and services and profits are relocated to countries with lower taxation.

Companies use this technique to increase their competitiveness and, at the same time, improve their results. This business strategy can be associated with a whole set of factors, such as the difference in tax burden between states and currency fluctuations (Melnychenko, 2017). Many companies provide intra-group administrative, technical, and financial services, and, in a tax planning logic, try to transfer their profits to countries with a privileged tax regime, through fictitious or fraudulent payments that are not associated with real and objective transactions.

When analysing transfer prices of intra-group services, it is essential to assess two aspects: firstly, whether the service was actually provided within the group; and secondly, whether the amount charged is in line with the arm's length principle, as stipulated by the OECD (2022). The development of a clear and objective transfer pricing regime is fundamental for decision-making and the accountability of the entities involved. As Jordan et al. (2011) point out, transfer pricing is an instrument for valuing the real flows of tradable goods and services and acts as an instrument for valuing the flows between related entities that depend on their tax planning capacity.

The practice of transfer pricing that has been observed in transactions involving tangible and intangible assets or the provision of services between two associated companies, as defined in accordance with the arm's length principle, according to the OECD Guidelines (2022), has caused an erosion of the tax base, a risk to countries' fiscal sovereignty and has become one of the most efficient tools for obtaining greater tax gains.

According to Spicer (1988), it is a strategy that takes into account the diversity of business activities, the nature of business relationships, the organisational structure, and the accounting and management control system, with a view to maximising profit. For Elliott and Emmanuel (2000), it is not only related to the price of goods and services, but also to the amount of income that each entity obtains from commercial or financial transactions between related parties. These are transactions that include operations related to tangible or intangible assets, rights, or services, and are carried out as part of negotiations, as a result, in particular, of sharing costs and providing intra-group services.

This manipulation of results stems mainly from the tax advantages of certain countries and territories, which lead organisations to undervalue goods and services in high-tax states and overvalue them in lower-tax states (Pereira, 2013). This is why transfer prices are seen, according to Jordan et al. (2011), as instruments for valuing the real flows of goods and services transacted between the different centres of responsibility, whose development of the transfer pricing system plays an important strategic role in decision-making and in assessing the performance of the various decision-making centres. In the end, they function as an instrument for evaluating flows between decision centres, but they should not be equated with the accounting concept of 'internal provision'.

Reasons for litigation

The problems are due to the diversity of elements involved in transfer pricing, according to Martins and Correia (2018), which hinder the comparability process and end up creating situations of "confrontation" between taxpayers and the Tax and Customs Authority (AT). This occurs in the case of multinational companies that develop a wide range of administrative, technical, financial, and commercial services in several countries, which allows them to optimize their resources and carry out good tax planning. Companies that need a service have the option of acquiring it through a third company or directly through a company of the group (i.e., intra-group), at a more competitive price. Related companies can, for example, benefit from the immateriality of intra-group services in order to more easily transfer profits between companies from one jurisdiction to another with a more favourable tax regime for the company, according to Martins and Correia (2018).

To overcome the "confrontation" between taxpayers and tax authorities, it is expected that transfer prices practiced between related entities should be equal to prices between independent companies in similar circumstances (Göx and Schiller, 2006). To this end, entities must choose the most appropriate transfer pricing method possible. Therefore, before choosing the method, they should analyze the circumstances surrounding the specific case to make the best choice and thus optimize their prices, according to Ondrušová (2016). Therefore, it must be verified whether there are economic, financial, or commercial reasons that justify these operations or whether they give rise to 'possible deviations from market standards' (Lucas, 2022, p. 19).

It should be noted that the main motivations for adopting the pricing method are related, notably, to the high tax burden, the complexity of tax legislation, the inefficiency of tax administrations in

monitoring abusive tax planning operations, the lack of systematic tax control over transfer prices and the widespread feeling of impunity in relation to illicit economic and financial practices.

In order to avoid or reduce tax payments, companies tend to transfer their tax obligations to countries with a lower tax burden, using a more effective cost-cutting strategy. This redistribution of economic resources prevents the taxation in question from having a negative impact on the stability of the individual and global economy.

The issue of transfer pricing has led to situations of abusive tax planning and erosion of the tax base and, consequently, successive disputes. The issue of transfer pricing has caused successive disputes. Countries have been confronted with high risks of litigation due to the techniques used by multinationals and the losses they can cause to countries' tax revenues (Khris and Whiteside, 2020).

Companies carry out risk management that leads to manipulation of transfer prices, according to Melnyk (2017). This corporate strategy aims to increase business competitiveness by reducing exposure to risks and minimising losses between related companies, related to exchange rate fluctuations, currency volatility, political instability, and different tax burdens between jurisdictions, among others. According to Zinn and Riedel (2014), minimising tax obligations by shifting income can be done in several ways, namely through intra-group financing, centralising functions, and adjusting prices in the exchange of intra-group goods and services.

This strategy involves separating the related entities into separate companies, thus allowing expenses to be deducted in one jurisdiction and payments to be received in another. Companies are thus able to manipulate transfer prices by transferring their profits to countries with lower taxes, moving them away from countries with a higher tax burden. According to Lin and Chang (2010), organisations try to undervalue goods and services from high-tax states and overvalue these same goods and services in lower-tax states, which means that the taxation of linked transactions takes place in the country with the lowest tax burden. This strategy also aims to improve management performance, resource efficiency, and increase market share (Amorim, 2014, p.8).

This strategy of companies trying to circumvent legal requirements in order to reduce their tax burden has led tax administrations to develop anti-abuse rules designed to penalise transfer pricing manipulation, the erosion of tax bases and the violation of tax equity between countries. This occurs in the case of intangible assets where it is more difficult to determine the type of transaction (such as granting licences or making a sale), the category of intangible assets (namely trademarks,

patents, know-how, rights derived from contracts, among others), the duration and degree of protection, as well as assessing future benefits, according to Amorim (2014). It is worth highlighting the use by multinationals of aggressive transfer pricing strategies to localise intangible assets in subsidiary jurisdictions with low levels of taxation or in jurisdictions with less regulation in this area.

Martins and Correia (2018) emphasise, at this point, the complexity underlying the process of evaluating and valuing these assets, comparing and valuing intangible assets, due to their intangible nature.

There has been a certain difficulty in the process of evaluating and valuing certain assets, especially intangible assets, due to their complexity, which has the effect of making it difficult to determine prices according to Martins and Correia (2018). This type of asset is often negotiated and traded internally (intra-group), which makes it difficult to identify external comparables in order to apply the arm's length principle. This complexity may also be because linked entities develop intangible assets and then transfer them to fiscally privileged countries.

This is why jurisdictions have, according to Chand (2016), significantly increased their attention to transfer pricing aspects in international financial transactions between related parties, for example, in the case of intra-group loans, financial guarantees, cash pooling mechanisms (centralised management operations), which can lead to base erosion and profit shifting (BEPS). According to Martins and Correia (2018), financial transactions are difficult to assess due to their complex and sophisticated nature and the difficulty in establishing comparability between linked and independent transactions.

In this sense, the OECD has played a significant role in defining international transfer pricing standards through its Transfer Pricing Guidelines, with a view to guiding jurisdictions on the need to adopt more efficient tax policies to combat the erosion of the tax base and the transfer of profits to other countries. To this end, the OECD requires, in particular, in actions 8 to 10, an ‘alignment of transfer pricing results with value creation’ and in action 13 a ‘transfer pricing documentation and Country-by-Country report’ with the aim of increasing transparency for tax authorities. Action 13 is covered by Ministerial Order 268/2021 and Article 63 of the CIRC, which require multinationals to submit transfer pricing documentation, namely the preparation and maintenance of a Master File and a Local File.

3. METHODOLOGY

The high potential litigation underlying the transfer pricing issue, which is the subject of this study, raises several issues that need to be clarified, namely the type of linked transaction that is frequently questioned by the AT, the applicability of the underlying transfer pricing regime, the transfer pricing method most used by the AT, the adjustments made by the AT and the meaning and implicit reasons for CAAD decisions.

In order to ascertain these issues, the meaning of the arbitration decisions was analysed, and a selection of arbitration court decisions was made in order to understand the problems of operations carried out by related companies, based on an analysis of tax litigation in this area. We carry out a content analysis of tax disputes ruled on by arbitration courts in matters of transfer pricing.

The time period defined for the selection of the arbitration court decisions starts from the time CAAD's arbitral tribunals become operational (October 2012) until 31 August 2024. The arbitral decisions were obtained from the database available on the CAAD website. The first search criterion selected was 'Theme', in which 'transfer pricing' was chosen, resulting in 71 cases with a decision date between January 2013 and August 2024. Additionally, the 'Theme' search criterion selected 'Cash Pooling' and 'Full Competition Principle' resulted in a further 3 cases, totalling a sample of 74 arbitral rulings. The sample of 74 arbitration decisions, with a decision date between October 2012 and August 2024, is composed of 69 related to corporate income tax, 3 related to personal income tax, 1 related to VAT, and 1 related to both corporate income tax and VAT.

Table 1. Total of Arbitral Decisions categorized by type of tax

Taxes	Number of Arbitral Decisions
Corporate Income Tax	69
Personal Income Tax	3
Value Added Tax	1
Corporate Income Tax and VAT	1
TOTAL	74

Source: Based on the empirical study of Arbitration jurisprudence (CAAD Website)

Given the size of the sample and the growing tendency of taxpayers to resort to this method to resolve disputes, we found a variety of situations that contributed to the perception of common

transfer pricing problems. This study looks at the type of transaction, the arbitration decision, the type of tax, the subject of the dispute, the value and costs of the proceedings, the reason for the dispute, the arbitration decision, and the adjustment method. This study resulted in a detailed and substantiated analysis of the 74 arbitration decisions.

Firstly, an analysis was made of the nature of the linked transactions in dispute. In a second phase, the AT's main challenges regarding the applicability of the regime were identified. In a third phase, the methods used to determine transfer prices were analysed with a view to the adjustments made by the AT. In the fourth phase, the predominant direction of CAAD's decisions was determined, based on the number of arbitration decisions in favour of the AT as opposed to those in favour of the taxpayer. This was followed by a more in-depth analysis of the arbitration decisions and concluded with the main results of the study.

4. EMPIRICAL STUDY

As a result, in all 74 arbitration decisions between October 2012 and August 2024, the transactions most contested by the AT are financial transactions and transactions of goods between related companies. Financial transactions and intra-group transactions of goods represent approximately 62 per cent of all transactions in dispute. Intra-group financial transactions alone account for 47 per cent of arbitration decisions, and are the transactions with the highest incidence of litigation between the AT and the taxable person. The second most disputed transaction concerns intra-group property transactions, which correspond to 15 per cent of all arbitration decisions in the sample.

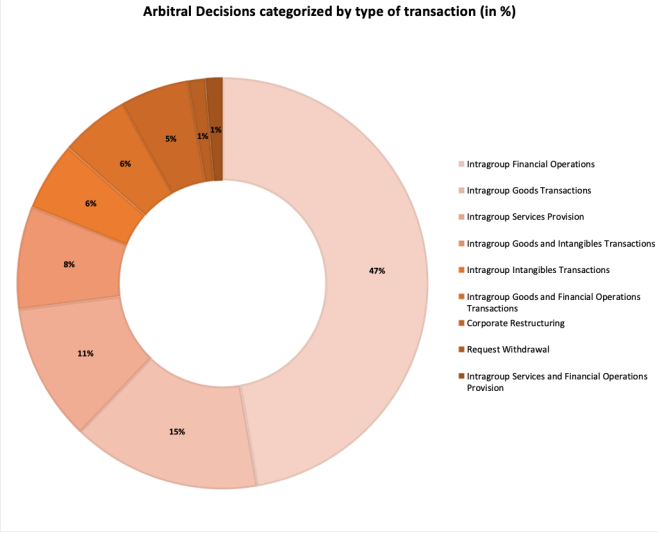

Figure 1. Total of Arbitral Decisions categorized by type of operation (in %).
Source: Based on the empirical study of Arbitration jurisprudence (CAAD Website)

In fact, 40 of the arbitration decisions relate to financial transactions, of which 35 relate to isolated operations and the remaining 5 relate to intra-group transactions of goods or services. About intra-group goods transactions, there were substantially fewer cases, i.e., 21, which is the second most litigated transaction between the AT and taxpayers.

Table 2. Total of Arbitral Decisions categorized by type of Operation

Type of Transaction	Number of Arbitral Decisions
Intragroup Financial Operations	35
Intragroup Goods Transactions	11
Intragroup Services Provision	8
Intragroup Goods and Intangibles Transactions	6
Intragroup Intangibles Transactions	4
Intragroup Goods and Financial Operations Transactions	4
Corporate Restructuring	4
Request Withdrawal	1
Intragroup Services and Financial Operations Provision	1
TOTAL	74

Source: Based on the empirical study of Arbitration jurisprudence (CAAD Website)

The fact that financial transactions are the most contested has essentially to do with their extreme complexity and their consequent degree of comparability with other non-binding transactions. It is therefore clear from an initial analysis of the 74 cases presented that the main reason for the AT's disputes lies in the lack of comparability of linked transactions.

This reason is the main cause that arises exclusively in 17 cases and together with other disputes in 17 other cases, which makes a total of 34 arbitration decisions issued. The degree of comparability has been analysed by the AT in most transactions between related entities, which has compared the characteristics of the assets and services in the linked transactions with the unlinked transactions.

4.1 The meaning of CAAD's decisions

4.1.1 Decisions more favourable to taxpayers

From the overall analysis of the sample of 74 arbitration decisions, we can see that 60 cases were favourable to the taxpayer, 12 were favourable to the AT, 1 was partially favourable to the taxpayer and 1 was subject to a partial revocation by the AT due to the taxpayer withdrawing his request for the remainder of the case.

In other words, the decisions handed down by the arbitration courts are predominantly favorable to the taxpayer, in the sense that 81% of the arbitration decisions are in favour of the taxpayer and only 16% are in favour of the AT. In the case of decisions in favour of the taxpayer, the tribunal declared the annulment/reversal of the tax acts issued by the AT and the application of compensatory interest. The decisions in favour of the taxpayer were essentially the result of deficiencies on the part of the AT in applying the principle of comparability and the methods underlying the adjustments made by the AT, as well as imperfections and inaccuracies in the application of the assumptions of the PT regime and in the justification for the adjustments made.

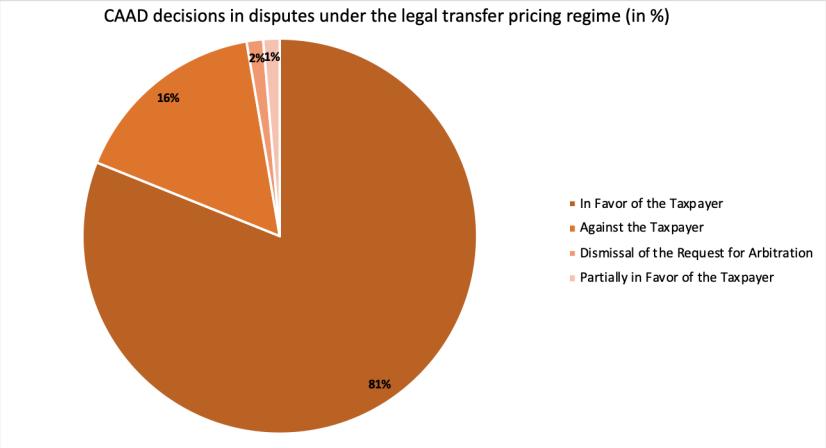

Figure 2. Meaning of CAAD decisions in disputes under the legal transfer pricing regime (in %)
Source: Based on the empirical study of Arbitration jurisprudence (CAAD Website)

The general profile of the decisions made by the arbitration courts can be defined by the type of transaction: intra-group financial transactions, intra-group asset transactions, intra-group intangible transactions, and corporate restructuring.

The intra-group financial transactions underlying the cases analysed are divided into the acquisition of shares, acquisition by merger, cash pooling, assignment of contractual position, exchange of real estate for own shares, sale of shareholdings, intercompany loan agreement, purchase and sale of shares between shareholders, assignment of credits, intra-group debts, and non-remunerated share premium. The financial transactions are characterised by a high degree of litigation between the AT and the taxpayer. This phenomenon occurs because the guidelines and the legislation in force are not sufficiently clear and objective to guarantee adequate resolution of the issues that arise during the price determination process, especially with regard to the arm's length interval.

The study also shows that of the 40 cases involving intra-group financial transactions, only 4 were judged in favour of the defendant, in this case, the AT. The arbitration courts, in a pragmatic, reasoned, balanced approach and in defence of taxpayers' rights and interests, favoured the economic substance of transactions over form, requiring, for example, the reclassification of capital transfers to subsidiaries.

The arbitral tribunal has been stricter in demanding solid legal grounds from the tax authorities, criticising them when they fail to provide fair and adequate justifications for the application of transfer pricing tax regimes and demanding greater transparency and precision in the application of legal rules. The arbitral tribunal, while recognising the legitimacy of the AT's inspection, has demanded an impartial stance from the latter, rejecting allegations of bad faith or ill-founded tax corrections. The arbitral tribunal has also shown a certain sensitivity in the relationships established between companies operating in the same sector of activity, where, for example, in one of the cases analysed, it accepted the creation of impairments on inventories based on the extremely rapid devaluation of products.

The arbitral tribunal demonstrates a fair and equitable contextual analysis that reflects an understanding of market dynamics and the reality of the companies involved, by reinforcing its commitment to tax justice in guaranteeing the cancellation of undue tax acts or the return of unjustified amounts paid. Finally, the arbitral tribunal guarantees a degree of rigour by ensuring the fair and contextual application of the tax rules in force and establishing an adequate legal basis to defend the rights of the parties involved.

4.1.2. Intra-group transactions involving goods and services

The intra-group transactions of goods and services underlying the cases under analysis include the sale of real estate assets, the purchase/sale of products, the exchange of real estate, and financial transactions.

Multinational companies usually centralise financial, technical, or commercial services in countries with preferential tax regimes, with a view to reducing costs and thus increasing their productivity, on the one hand, and intensifying their tax efficiency, on the other. This centralisation allows one or more services to be provided to all group entities. The transactions carried out between the subsidiaries that make up multinational companies, known as intra-group services, have the main objective of providing economic and tax advantages to the linked entities. However,

these transactions are often not real or are inflated and are designed to simulate intra-group transactions of goods and services in order to make a greater profit.

In addition to this economy of scale advantage, there is also tax efficiency, which allows companies to exploit the differences in tax regimes between the various jurisdictions where the different subsidiaries are located and potentially reduce the group's overall tax burden. It is precisely at this point that the potential points of dispute between taxpayers and the AT arise. From the analysis carried out on this point, 30 cases underlying intra-group transactions of goods and services were judged, 5 of which were favourable to the AT, which conveys a careful and reasoned analysis on this matter, based on compliance with the law. The AT's approach is to ensure that the prices charged in transactions between related parties are in line with market values. The arbitral tribunal requires a rigorous comparison between the prices practised in internal transactions and those applied in similar operations between independent companies, which often use traditional methods based on the comparable market price or the cost plus.

Table 3. Arbitral Decisions regarding intragroup transactions in goods and services, disputes subordinated to the legal regime of transfer pricing

Type of Transaction	Arbitral Decisions	Adjustment Method	Number of Arbitral Decisions	Total Value of Cases (€)
Intragroup Services and Financial Transactions	In Favor of the Taxpayer	Comparable Uncontrolled Price (CUP)	1	€658,206.55
Intragroup Services	In Favor of the Taxpayer	CUP	2	€1,048,608.05
		Not Specified/Not Used	6	€1,593,751.44
Intragroup Transactions of Goods and Intangibles	In Favor of the Taxpayer	CUP	6	€22,709,701.03
Intragroup Goods and Financial Transactions	In Favor of the Taxpayer	CUP	4	€2,926,484.10
Intragroup Transactions of Goods	Against the Taxpayer	Transactional Net Margin Method (TNMM)	3	€4,268,877.51
		CUP	2	€206,941.13
	In Favor of the Taxpayer	CUP	5	€2,040,104.68
		Not Specified/Not Used	1	€377,951.46
Total			30	**€35,830,625.95**

Source: Based on the empirical study of Arbitration jurisprudence (CAAD Website)

One of the crucial aspects to be emphasised here in the TA's decision-making has to do with the assessment of the evidence presented by the parties, namely the transfer pricing file, in order to be able to evaluate the support for the parties' claims. The arbitral tribunal must determine whether the evidence presented is robust and consistent and whether it accurately reflects the reality of the transactions carried out. The presentation of solid documentation is crucial to supporting and validating the prices charged.

Another determining factor in the TA's decision-making has to do with the interpretation and application of current tax legislation. In the cases under analysis, the judges do not hesitate to annul tax corrections that are not duly substantiated, ensuring that taxpayers are not unduly penalised. The TA, as the protector of rights and interests in tax matters, has also guaranteed the payment of compensation to taxpayers by recognising the particularities of the prices charged and the conditions of the transactions.

The TA's understanding is that commercial transactions must be carried out fairly and in accordance with the rules in force.

4.2. Intra-group intangible transactions

In cases of intra-group intangible transactions, several disputes have arisen concerning the purchase/sale of intangible assets, the production of intangible assets, the transfer of business, the disposal of shareholdings, and the payment of royalties. We have identified 10 cases concerning intra-group intangible transactions, only 1 of which was judged in favour of the AT. In this case, the arbitral tribunal required adequate reasoning from the AT before making any tax correction. The arbitral tribunal has rejected all cases that are not based on clear and substantial evidence in decisions relating to royalties, thus rejecting AT decisions whenever it cannot prove that the amounts paid are excessive or do not correspond to real operations.

Table 4. Arbitral Decisions regarding intragroup intangible transactions, disputes subordinate to the legal transfer pricing regime

Type of Transaction	Arbitral Decisions	Adjustment Method	Number of Arbitral Decisions	Total Value of Cases (€)
Intragroup Transactions of Goods and Intangibles	In Favor of the Taxpayer	Comparable Uncontrolled Price Method	6	€22,709,701.03
Intragroup Transactions of Intangibles	Against the Taxpayer	Transactional Net Margin Method	1	€2,090,550.08
	In Favor of the Taxpayer	Comparable Uncontrolled Price Method	3	€932,865.93
Total			**10**	**€25,733,117.04**

Source: Based on the empirical study of Arbitration jurisprudence (CAAD Website)

In addition, the arbitral tribunal has validated the transfer pricing methodologies used by companies and accepted the cost-plus and net margin methods, considering them more appropriate to ensure compliance with the arm's length principle. These methods were considered appropriate according to the specificities of the transactions, in terms of their value, context, and characteristics.

More specifically, the arbitral tribunal recognised the legitimacy of royalty payments and other charges to related entities, provided that they prove that the payments made are essential to their activity and are within market parameters. The TA's analysis revealed a concern to ensure that tax practices respect the principles of tax justice and ensure the protection of taxpayers' rights.

In this context, the arbitral tribunal emphasised the existence of transactions with privileged tax regimes, but considered that these alone are not sufficient to justify any corrections, and that it is necessary to investigate in greater depth the nature of the transactions, the risks involved, and the practices of the sector in question. The arbitral tribunal believes that the burden of proof in relation to the taxpayer's practices lies with the AT and did not hesitate to order the AT to pay damages and legal costs arising from assessments deemed illegal due to the lack of reasoning in its decisions. The arbitral tribunal has positioned itself as a defender of tax equity, seeking to establish a fair and transparent tax environment where intangible transactions between related companies are treated appropriately and in accordance with market practices.

4.3. Restructuring operations

In restructuring operations, 4 cases were judged, only 1 of which was considered favourable to the AT. The TA's decision shows the complexity of corporate restructurings, especially with regard to the practice of transfer pricing and the tax implications arising from it.

Table 5. Arbitral Decisions relating to corporate restructuring, disputes under the legal regime of transfer pricing

Type of Transaction	Arbitral Decisions	Adjustment Method	Number of Arbitral Decisions	Total Value of Cases (€)
Business Restructuring	Against the Taxpayer	Comparable Uncontrolled Price Method	1	€138,160.50
	In Favor of the Taxpayer	Transactional Net Margin Method	1	€2,183,530.35
		Comparable Uncontrolled Price Method	2	€234,348.39
Total			**4**	**€2,556,039.24**

Source: Based on the empirical study of Arbitration jurisprudence (CAAD Website)

Corporate restructurings involve acquisitions and sales of assets between entities in the same group, which have significant tax repercussions. In the majority of cases, the AT has upheld the taxpayer's claim and condemned the tax authorities for failing to respect the arm's length principle in transactions between companies, particularly in the context of restructuring. The AT's analysis of transfer prices was, in most cases, considered inadequate by the AT and resulted in the tax corrections made by the tax authorities in relation to company restructurings being cancelled.

However, the AT recognises the need for a more in-depth assessment of tax issues due to the high degree of complexity in this matter. The only arbitration case in which the decision was unfavourable to the taxpayer concerned the acquisition of a company for a value higher than the market value, which resulted in negative consequences for the taxpayer, highlighting the importance of a rigorous and well-founded assessment to avoid possible future financial losses. The arbitral tribunal emphasised that the prices charged should be in line with market values to avoid possible tax complications. The arbitral tribunal also rejected the idea that tax adjustments should be targeted at a specific entity and that the AT's decisions on assessments should be independent and duly substantiated. The arbitral tribunal demonstrates the need for careful

management of operations and proper documentation in restructuring processes to avoid costly tax penalties and corrections.

In short, the arbitral tribunal decisions emphasise the need for strict compliance with tax rules and the correct application of the arm's length principle and the principle of comparability in business transactions. This unfavourable decision for the taxpayer should be seen as a warning sign for companies carrying out restructurings, emphasising the importance of proper price evaluation, meticulous documentation, and the risks of tax implications.

4.4. Results of the empirical study

Transfer pricing is not a simple and linear matter, and is subject to a high degree of complexity and subjectivity on the part of the various decision-makers. Given this complexity and subjectivity, there is a high probability of disagreements between taxpayers and the AT. The AT faces a complex and difficult situation when it comes to monitoring and litigating PT. According to Martins and Correia (2018, p.167), "not only are the rules on the matter, worldwide, riddled with multidisciplinary concepts, complex application and case-by-case contours that are often not fully apprehensible in inspection actions, but the means that economic groups have make litigation on this subject somewhat adverse for the AT".

From this study, we conclude that the type of transaction most questioned by the AT are financial transactions between related companies, which include acquisitions of shares, mergers, cash pooling, assignment of contractual position, exchange of real estate for own shares, sale of shareholdings, intercompany loan agreements, purchase and sale of shares between shareholders, assignment of credits, non remunerated share premiums and debts receivables.

Tax controls of financial transactions revealed discrepancies regarding the distribution of cash pooling gains, disagreements with taxable persons regarding the interest rate to be applied to intra-group loans or the lack of remuneration in certain intra-group financing operations, high values of share purchases and sales compared to market values, deferred payment agreements without any financial consideration or transactions carried out with entities located in privileged tax regimes or tax havens.

Concerning financial transactions, the AT has questioned the terms and conditions of financial transactions between companies because contractual agreements do not always provide sufficiently detailed, transparent, and real information. In addition, there are a variety of financial instruments on the market with very different characteristics and attributes, which can affect the

underlying prices of financial transactions between related companies and lead to disputes with the tax authorities.

The main disputes mainly concern the assumptions for comparability of transactions, the application of the legal regime, and the calculation methodology used. The difficulty here lies in qualifying the nature of the transactions and comparing them with transactions carried out with independent entities. For taxable persons, there are substantial differences that affect comparability, and that must be taken into account in the prices charged, such as contractual conditions, geographical location, the time factor, and the functions and activities performed by the parties.

The analysis of all these factors is essential to establish proper comparability and avoid unfavourable decisions for taxpayers. To this end, the parties must follow the applicable tax legislation and the OECD guidelines, which establish the fundamental principles for the application of transfer pricing methods. The AT, on the other hand, believes that, in some of the cases analysed, the prices charged by the taxpayers are not within the compliance range and that, to this end, they should be adjusted. These differences between the AT and the taxpayers are basically the result of differences in the comparability of the transactions, in the fulfilment of the legal assumptions, and in the application of the calculation methodology.

The most widely used methodology for calculating transfer prices has been the Comparable Uncontrolled Price (CUP), as it is considered to be the most reliable method, although it is not always possible to achieve the required degree of comparability, which means that in some transactions it cannot be applied, which has often been contested by taxpayers and has led to unfavourable decisions for the AT.

Table 6. Arbitral Decisions regarding intragroup transactions in goods and services, disputes subordinated to the legal regime of transfer pricing

Type of Transaction	Arbitral Decisions	Adjustment Method	Number of Arbitral Decisions	Total Value of Cases (€)
Intragroup Services and Financial Transactions	In Favor of the Taxpayer	CUP	1	€658,206.55
Intragroup Services	In Favor of the Taxpayer	CUP	2	€1,048,608.05
		Not Specified/Not Used	6	€1,593,751.44

Intragroup Transactions of Goods and Intangibles	In Favor of the Taxpayer	CUP	6	€22,709,701.03
Intragroup Goods and Financial Transactions	In Favor of the Taxpayer	CUP	4	€2,926,484.10
Intragroup Transactions of Goods	Against the Taxpayer	TNMM	3	€4,268,877.51
		CUP	2	€206,941.13
	In Favor of the Taxpayer	CUP	5	€2,040,104.68
		Not Specified/Not Used	1	€377,951.46
Total			**30**	**€35,830,625.95**

Source: Based on the empirical study of Arbitration jurisprudence (CAAD Website)

Of the 74 arbitration rulings, the AT appealed to the Comparable Uncontrolled Price (CUP) and made corrections to 52 intra-group transactions, considering that the prices charged between related parties did not comply with the principles of full competition and comparability. This is why the AT made corrections to adjust the values and avoid harmful tax distortions. These adjustments are only possible if there is no fair comparability between transactions carried out with or between independent companies. Of the 74 case law decisions observed, the arbitration courts ruled in favour of the taxpayers in 60 cases (and partially in favour in only one case), which shows that 81% of the cases were dismissed by the AT due to the lack of comparability with independent transactions. Therefore, the predominant direction of CAAD's decisions is in favour of taxpayers.

The AT itself does not always comply with the legal requirements and, in some cases, has even tried to reverse the burden of proof, claiming that taxpayers have failed to fulfil ancillary obligations. However, the AT has not proved that the terms and conditions that were agreed, accepted, or practised are different from those that would have been applied with or between independent companies. Furthermore, the AT has faced some difficulties in its defence, as a result of its insufficient reasoning and the lack of evidence regarding the terms and conditions of the linked transactions compared to those that would have been practised with or between independent entities. As a result, the courts have ended up ruling in favour of the taxpayer. In the various cases, AT inspectors disagreed with the arguments put forward by the taxable person, also due to their lack of knowledge of the activities carried out and the economic factors that influence transaction prices.

In the 12 cases in which the AT obtained a favourable decision, the arbitral tribunal considered that it had complied with all the legal requirements regarding the use of criteria for comparing transactions and the choice of the most appropriate method, considering that different terms and conditions had been applied than those applied by independent companies in similar situations. An analysis of the arbitration rulings shows that the main causes of dispute between the AT and taxable persons arise in intra-group financial transactions and transactions involving favoured tax regimes. In these favourable rulings, the AT's approach was considered rigorous, solid, and appropriate in terms of the choice of methods used, the application of the principles of full competition and comparability, compliance with legal requirements, and the support of tax corrections. To make its decisions more transparent, the AT is required to give reasons for its decisions and to prove that they comply with the legislation in force.

5. CONCLUSION AND DISCUSSION

Transfer pricing is a crucial issue for companies seeking greater international profitability. Transactions between related companies from different jurisdictions have led to the manipulation of transfer prices by shifting profits to more favourable countries or territories. Faced with this challenge, it is imperative to strengthen legislation in order to combat all types of aggressive tax planning and ensure that companies pay taxes in the countries where the profit is generated (OECD, 2022). The OECD, through international guidelines, has been playing a crucial role in the process of regulating transfer pricing, namely with the BEPS Action Plan, launched in 2015, aimed at actively combating and preventing the erosion of the tax base through the artificial transfer of profits. In Portugal, the implementation of legislative measures is in line with the OECD recommendations, which provide a standardised regulatory framework at a global level (Hidalgo, 2017) and thus make it possible to increase transparency in economic transactions.

The empirical study carried out on transfer pricing tax disputes in Portugal has brought to light several determining factors that influence the decisions of the arbitration courts at CAAD. The analysis of 74 arbitration decisions handed down between 2012 and 2024 reveals that the main points of dispute between the AT and taxable persons are related to the principle of comparability of linked transactions, the methodology used to determine transfer prices, the legal assumptions applicable to intra-group transactions and the involvement of jurisdictions with more favourable tax regimes, which end up having a strong impact on the public finances of states.

Through this study, it was possible to observe that the decisions of the CAAD are generally favourable to taxpayers, the decisions contributed to filling the regulatory gaps, and therefore that transactions between related parties comply with the arm's length principle.

It was also noted that the application of the CUP requires a high degree of comparability that cannot always be demonstrated by the AT services, which resulted in challenges by taxpayers and in arbitration decisions being more favourable to taxpayers (81% of the cases handed down). In the majority of cases, the AT had difficulty in supporting the corrections made to the tax base, namely due to insufficient evidence to show that the terms and conditions of transactions between related entities differed from those that would have been practised with or between independent entities.

The burden of proof has also proved to be a decisive factor in many disputes, often leading to favourable decisions for taxpayers. However, in the cases in which the AT obtained favourable rulings, the approach was considered very prudent and well-founded, based on a rigorous comparative analysis, justified and clear as to the methods used in the corrections made. In these cases (12 out of 74 cases analysed), the correct application of the legal principles and requirements led to the tax corrections being validated by the arbitration courts.

It should also be noted that this study was limited to the case law handed down between 2012 and 2024 by CAAD's internal arbitration courts and does not take into account the case law of other courts and countries, which could have resulted in a different conclusion on transfer pricing decisions. There is also a limitation deriving from the complexity of transfer pricing, which involves multidisciplinary concepts and requires a more objective and less subjective analysis of the comparability between operations.

For future research, it would be interesting to analyse national court decisions and those of other international jurisdictions. Based on this analysis, it would be possible to establish global transfer pricing benchmarks by comparing different judicial and legislative approaches, and to better understand how international standards are interpreted and applied in different contexts. In addition, it would be important to explore the impact of technology, such as artificial intelligence and Big Data, on transfer pricing analysis, since these technological tools can significantly improve the accuracy of tax audits and comparability analysis, reducing subjectivity and disagreements between tax authorities and taxpayers. Finally, this analysis would have the effect of bringing benefits in terms of the fairness and efficiency of tax systems.

The OECD guidelines and, in particular, the BEPS Plan have made it possible to reinforce the principle of full competition by reducing price manipulation practices (OECD, 2022). According to Devereux and Vella (2014), these developments have increased tax transparency and allowed for greater international co-operation between tax authorities, which has helped to reduce the erosion of tax bases. Improved regulation and the alignment of business practices with international rules are, therefore, necessary to ensure greater legal certainty for taxpayers (Pistone, 2014) and thus strengthen the ability of tax administrations to correct any abusive tax operations.

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