Belgian Court of Appeal Wipes the Floor with Ambulatory Use of 2017 Transfer Pricing Guidelines – But Not without Testing the Tax Authorities’ DEMPE Function Analysis

In this article, the author analyses a case decided by the Belgian Court of Appeal (Ghent) on 8 June 2021, which concerns the application of the DEMPE functional analysis by the Belgian tax authorities on a patent developed and exploited by a Belgian group of companies. The decision and the analysis focus on two questions: first, whether the OECD Transfer Pricing Guidelines (2017) of which the DEMPE functional analysis forms a crucial new addition can be applied dynamically to facts that took place before their adoption; and secondly, whether the tax authorities’ DEMPE functional analysis in the case at hand was correct.

1. Introduction

Since the release of the OECD/G20 BEPS Actions 8-10 Final Report on the aligning of transfer pricing outcomes with value creation, it has become clear that legal ownership of an intangible by a group company does not, in itself, generate a right to any of the return that is generated by the exploitation of the intangible by third parties. In the post-BEPS era, the return generated by the intangibles of the group is to be attributed in function of the value of the functions performed, risks assumed, and assets contributed by each group company in relation to the intangible.

Detailed guidance has been introduced in the 2017 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines) on the question whether and to what extent group companies that are not the legal owner of intangibles need to be compensated for the performance of functions that contribute to an intangible’s value. These functions are described as relating to the development, enhancement, maintenance, protection and exploitation (DEMPE) of the intangible. The DEMPE functional analysis has rapidly become a hot topic in transfer pricing compliance. Tax courts around the world will not be spared from dealing with complex questions of characterization and mischaracterization of DEMPE functions by both taxpayers and tax authorities.

In this article, a detailed analysis is provided of the first Belgian judicial decision regarding a DEMPE functional analysis. In its decision of 8 June 2021, the Court of Appeal in Ghent considered whether the upwards adjustment of the profits of a Belgian group company based on a DEMPE function analysis concerning an industrial patent held by an Irish group company was justified.

After a description of the facts and the position taken by the tax authorities, the focus in this article will be aimed on the Court of Appeal’s holdings with regard to two issues: first, whether the OECD Guidelines could be applied in an ambulatory fashion and, in particular, whether the DEMPE function analysis, which has been introduced in the OECD Guidelines in 2017, could be applied to taxable events taking place in 2009; and second, whether the tax authorities’ factual DEMPE function analysis in the case at hand was correct. In the final part, a number of observations on the decision are provided.

2. Facts of the Case

The taxpayer was a company resident in Belgium (BELCO) and part of multinational enterprise (MNE) active in the business of engineering, manufacturing and marketing construction materials. In 1996, the employees of BELCO developed a technical solution that allowed for the efficient installation of floorboards. In the period of 1997 to 1999, it was a Dutch group company of the MNE (NEDCO), that obtained patents for product design with patent offices in Belgium, the European Union and subsequently also in the United States. A patent licence agreement was signed in 1998 between NEDCO (the licensor) and the taxpayer, BELCO (the licensee). In the agreement the latter was granted a licence to exploit the patented design in exchange for the payment of royalties. The parties furthermore agreed that that the taxpayer would recognize the Dutch group company as the owner of the intellectual property related to the product design and would relinquish all rights or claims in this regard, accepting that it had been sufficiently compensated for the development of the design in the form of the bene-
cational conditions under which it was allowed to exploit the technology.

In the end of 1999, a new group company was incorporated in Ireland (IRECO). By agreement of signed in the beginning of 2001, and after receiving approval from the Dutch tax authorities, the economic ownership of the patent was transferred to IRECO as of 1 April 2000. For this transfer IRECO paid to NEDCO a fee of about EUR 3 million. Also on 12 January 2001, a licence agreement was signed between BELCO (the licensee) and IRECO (the licensor) according to which the former is entitled to exploit the design in the manufacturing of floor products. BELCO was not held to pay any royalties, but any rights on the improvements made to the technology by the taxpayer pertain to IRECO, the licensor.

On 1 October 2007, IRECO moved its seat of management from Ireland to Luxembourg. At that time, the value of the intangible had drastically increased and was determined to be around EUR 731.5 million. Shortly after the move, in November 2007, a second Belgian group company (BELSERCO) was converted into the shared service centre of the MNE, providing all kinds of services to other group companies on a contractual basis, including to the BELCO and to IRECO.

3. Investigation and Assessment by the Tax Authorities

The Belgian tax authorities started an investigation in 2009 with regard to the corporate income tax due by the taxpayer in relation to tax years 2006 to 2009. In 2012, they informed the taxpayer that they had extended the investigation period from 3 to 7 years due to the suspicion of tax evasion. The tax authorities contended that the implicit transfer by the taxpayer, BELCO, to NEDCO in the Netherlands of the right to formalise and subsequently to exploit the patented design, followed by the express transfer of the economic ownership of the patented technology by the taxpayer, had not been remunerated for it. Based on the functions performed by IRECO, which were of a supportive nature, the latter should be only entitled to profits from the intangible calculated at a 5% cost-plus rate. The tax authorities concluded that because BELCO, the taxpayer, had not been remunerated for the DEMPE functions it performed, it had effectively granted IRECO in tax year 2009 what qualified under article 26 of the ITC as an “abnormal or gratuitous advantage”. The size of the advantage was determined to be about EUR 75 million. The tax authorities furthermore rejected the carry-over of previous losses realized by the taxpayer, contending that these losses only came to exist because the taxpayer was not properly remunerated for the functions it had performed in tax years 2000 to 2008.

4. Legal Background

The tax authorities base the upwards adjustment of the taxpayer’s profits on article 26 of the ITC (1992). Article 26 reads as follows:

If a company resident in Belgium grants abnormal or gratuitous advantages … these advantages are added to its own profits, unless the advantages were included in the taxable income of the recipient.

Article 26 is a provision with a wide scope and applies to a company’s actions both in regard to related and unrelated enterprises. Any advantage granted by a company in whichever way or form can be caught by the provision if the granting of it is deemed “abnormal” or “gratuitous”. These two concepts are not defined in the law but have been the subject of extensive jurisprudence. An “abnor-

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mal advantage” is what is deemed contrary to common business practice. A “gratuitous advantage” is an advantage that is granted in the absence of any consideration. The terms are usually applied jointly.6

In an administrative guideline issued in 2006, the tax authorities expressly (re)confirmed that the arm’s length principle of article 9 of the OECD Model is embodied in article 26 of the ITC.7 Since 2004, article 26 as the legal ground of the arm’s length principle has been complemented by the introduction of article 185(2), which is modelled on article 9 of the OECD Model and which has formally introduced the arm’s length principle into Belgian tax law.8

In the case at hand, the tax authorities relied on the legal basis of article 26 rather than article 185(2), arguably because the latter provision – like article 9 of the OECD Model – is geared towards pricing clearly delineated transactions, whereas article 26 with its wide scope applies to advantages granted in any way or form, independent of a delineated transaction. The burden of proof to show that any of the advantages granted are abnormal or gratuitous lays with the tax authorities.

5. Decision by the Court of Appeal

The Court of Appeal dismissed the appeal by the tax authorities and rejected the additional assessment for tax year 2009.

5.1. First pricing correction: Relinquishing of the right to the patent

The Court of Appeal first observed that the assessment was based on the contention that the MNE’s transfer pricing policy was not in line with the arm’s length principle. For the correction of the profits of the taxpayer, the tax authorities applied article 26 of the ITC and referred to article 9 of the OECD Model and to the OECD Guidelines. Upwards profit adjustments were alleged to be due in relation to two intra-group transactions, namely the transfer of the rights to the patented design by BELCO to NEDCO, and the carrying on by the taxpayer of DEMPE functions in relation to the relevant intangibles without receiving remuneration.

The Court of Appeal dismissed the first profit correction. The tax authorities had argued that a correction was due because the agreement to transfer the patentable design did not contain a price adjustment clause, whereas unrelated enterprises would have included such a clause in their agreement. The tax authorities had however failed to provide evidence to support this claim or detail the consequences of it. The claim was thus rejected and in the remainder of the decision, the Court only focused on the second correction.

5.2. Second pricing correction: Attribution of DEMPE functions


The Court of Appeal observed that transfer pricing had to be based on a functional analysis that takes into account the functions performed, assets used and risks assumed by related enterprises in their mutual dealings. If the tax authorities contended that the pricing was not in line with the arm’s length principle and that an abnormal or gratuitous advantage had been granted by the taxpayer to IRECO for the purpose of article 26 of the ITC, it was for the tax authorities to prove such by means of a functional analysis.

The Court of Appeal observed that the parties were in disagreement whether the OECD Guidelines (2017) were applicable in the case at hand. The Court observed that the OECD Guidelines provided insights on the application of the arm’s length principle in practice and contained recommendations with regard to a country’s transfer pricing policy. The OECD Guidelines had, as such, no force of direct application in Belgium. The Court observed that it was however clear that the tax authorities had based their assessment of an “abnormal or gratuitous advantage” at least partly on the 2017 version of the OECD Guidelines. The Court observed that there are divergences across the 1995, 2010 and 2017 versions of the OECD Guidelines. Some of these divergences are mere clarifications that do not impact the content of previous versions. Other divergences introduce completely new sections that contain recommendations that were not included – not even covertly – in a previous version. The Court observed that examples of such new sections introduced in the 2017 version were the “DEMPE function analysis”9 and the section on “Hard-to-value intangibles” (HTVI)10 (chapter VI, section D.4, page 308) and that the additional assessment was partly based on these sections. The assessment concerned however income derived in 2009. As such, only the economic context and regulatory framework in place in 2009 were to be applied. The only versions of the OECD Guidelines available in 2009 were the OECD Guidelines (1995).

The Court of Appeal observed that later versions of the OECD Guidelines could be applied by the tax authorities but only to the extent that these versions contained relevant clarifications of the 1995 version and not additions. To the extent that the relevant sections in the 2017 version contained recommendations that were significantly evolved since the 1995 version, they should be left without application. The Court observed that such was the case for the sections on DEMPE functions and HTVI, which were newly introduced in the 2017 version.

The Court observed that its view on temporal application of the OECD Guidelines (2017) was also reflected in Administrative Guideline 2020/C/35 of 25 February 2020 that summarizes and provides comments on the OECD

Guidelines (2017). It is clearly indicated in the Guideline that it only applies to transactions between related enterprises taking place on or after 1 January 2018. The Court referred to the European General Court’s decision of 12 May 2021 (Luxembourg and Amazon EU v. Commission) in which the latter court had come to the same conclusion with regard to the application ratione temporis of the DEMPE functional analysis.11

5.2.2. DEMPE functions and the disregarding of separate legal entities

The Court of Appeal then observed that the tax authorities’ contention regarding the DEMPE functions carried out by the taxpayer was partly based on the underlying claim that it was the taxpayer and not IRECO who performed all important functions with regard to the intangible assets relating to the design process, while also assuming all of the risks, and without receiving any remuneration. Similarly, also the services provided to IRECO as of November 2007 by BELSERCO, the group’s service centre and also located in Belgium, were alleged to be performed by the taxpayer.

The Court observed that such claim essentially entailed the disregard of the separate legal personality of BELSERCO, but without relying on the doctrine of simulation or the application of the general anti-abuse rule in article 344(1) of the ITC. The Court referred to the Supreme Court’s decision of 2 January 2020 (No. F.18.0074.N) and reiterated the highest court’s holding that disregarding legal acts without applying anti-abuse provisions was in violation of the law.

The Court of Appeal added that such approach would also be at odds with the separate legal principle that underpins the arm’s length principle and which is the foundation of the OECD Guidelines on which the tax authorities were basing the assessment. The fact that most of the turnover of BELSERCO was derived from services provided to the taxpayer and the fact that this group company had its seat on the same location as the taxpayer did not change the fact that the company was a separate legal entity and had to be treated as such for the purpose of the DEMPE function analysis.

5.2.3. DEMPE function analysis by the tax authorities

Even though the Court of Appeal had already concluded that the relevant sections on the DEMPE function analysis in the OECD Guidelines (2017) did not have any interpretational value in the case at hand, the Court did consider the tax authorities’ DEMPE function analysis.

The Court of Appeal came to the conclusion that the tax authorities had also erred in their appreciation of the facts on which their DEMPE function analysis was based.

5.2.3.1. Development activities

The tax authorities contended, first of all, that the pricing of the relationship between the taxpayer and IRECO should take into account the taxpayer’s development activities with regard to the patented design. In its relation to IRECO, BELCO did not develop the intangible or assume any risks, or more precisely, the tax authorities did not provide evidence of such activities. At the moment IRECO obtained the economic rights of the patent from NEDCO, the latter was properly remunerated for this transfer. It had already been established by the Court that BELCO had transferred all rights and claims to the patent to NEDCO in the licence agreement of 8 January 1998. The arm’s length principle nature of the relationship between the latter and the taxpayer was not in dispute. The Court added that, for the purpose of determining the correct pricing in the relationship between BELCO and IRECO in tax year 2009, it would take into account activities of development of the patent, which took place in 1996, but it would have to ignore any prescription term, as well as the fact that the remuneration for the development was settled in 2001 when IRECO obtained the economic rights and granted a licence to the taxpayer. The same was true for any activities relating to introduction on the market, protection or exploitation undertaken by the taxpayer before 2001. IRECO paid an arm’s length price for the economic rights in 2001 that had been approved by the Dutch tax authorities. The Belgian tax authorities did not provide evidence that this transfer caused IRECO to be owed any remuneration to the taxpayer in 2009.

5.2.3.2. Protection activities

The Court of Appeal observed that the tax authorities were correct in concluding that the strategic activities concerning the enforcement of the patent in the period of 2000 to 2009 by means of both offensive and defensive patent infringement litigation procedures had been crucial to build the successful licensing activity of the patented design. It was not proven that these activities, designated by the tax authorities as “protection activities”, were undertaken by the taxpayer in 2009 or in any preceding year. It was undisputed that as of November 2007, IRECO had hired and paid a fee to BELSERCO to perform these activities. At that time, the latter company employed sufficient qualified staff to undertake these activities and there was no reason to doubt the submitted invoicing between the two companies. The tax authorities’ claim that in reality, it was the taxpayer that bore the costs and that the employees in question were effectively employed by the taxpayer and not by BELSERCO was insufficiently corroborated with evidence.

The Court of Appeal observed that it had been established that most of the value of the intangible had been created in the period of 2001 to 2007. The taxpayer’s claim that IRECO had been incorporated for the express purpose of assuming the risks related to the protection activities that include the interaction with all third-party licence holders. IRECO relied on subcontractors for the patent infringement detection and enforcement activities. One
of these subcontractors, besides BELSERCO in Belgium, was another Irish group company, incorporated in 2002. The Court observed that the fact that the latter company employed for its protection activities consultants that were at the same time employed by the taxpayer and that these consultants physically performed their activities in Belgium, rather than Ireland, did not imply that the protection activities by this second Irish group company were to be attributed to the taxpayer.

The Court observed that the evidence showed that as of 2003, for the purpose of the maintenance, protection and exploitation of the intangible in question, it was IRECO that performed the relevant activities, and it did so by relying on these subcontracted consultants and its own company directors and staff. All relevant litigation was undertaken in the name of IRECO and the latter bore all the costs. The procedures that were initiated by NEDCO were continued in IRECO’s name.

The Court of Appeal concluded that the tax authorities failed to show that the taxpayer undertook any activities relating to the protection of the intangible or assumed any of the related risks that would warrant a remuneration to be paid by IRECO to the taxpayer in tax year 2009. Similarly and equally important, there was no evidence that such remuneration would be paid in the case of independent enterprises in similar circumstances.

5.2.3.3. Maintenance and exploitation activities

The Court of Appeal observed that with regard to the recurring functions relating to the intangible, like managing the patent, market research, sales and after-sales – referred to by the tax authorities as functions of “maintenance” and “exploitation” – the taxpayer had rightly argued that these had not been performed by the taxpayer in 2009. The Court observed that there was no proof that the activities were carried on by the taxpayer or under supervision of the taxpayer. The taxpayer did not dispose of the required assets and staff to perform the activities. The staff that was responsible for the activities was employed by IRECO in Ireland or by BELSERCO, the group’s service centre located in Belgium, or by third parties. Only a single employee on the payroll of the taxpayer had been engaged in the relevant activities, but the taxpayer claimed that his salary had been charged to and was borne by IRECO, which also supervised the activities by said employee in this regard and assumed the risks. The Court concluded that it could not be held that the taxpayer was engaged in maintenance and exploitation functions regarding the intangible, nor was there evidence that independent parties in similar circumstances would have agreed on a remuneration. The fact that employees of the taxpayer, and more specifically the sales representatives of the MNE’s proprietary product brand that used the design, also reported on patent infringements they observed, did not change this outcome. Independent patent holders and licensees would agree on a remuneration being paid for the reporting on infringations of the patent by the licence holder. The Court observed that it was in the taxpayer’s own economic interest and in line with the application of the licence agreement in good faith that the taxpayer reported on patent infringements it observed.

5.2.3.4. Enhancement activities

The Court of Appeal observed that, contrary to what the tax authorities contended, the agreement signed on 12 January 2001 between IRECO and the taxpayer, according to which the latter would be entitled to the economic rights on any enhancement made to the patent in return for a free licence, was not contrary to market practices. The Court referred to the relevant sections of the OECD Guidelines (2017) in which it was noted that granting a free licence was especially relevant in case the licence holder was a manufacturing company that incorporated the patented technology in its products.13 The Court observed that the taxpayer rightly pointed out that because of the free licence, the taxpayer had been able to avoid paying a significant amount of royalties over the years and that the free licence constituted an important competitive advantage. There was altogether no proof that this arrangement was not at arm’s length.

The Court of Appeal held that the tax authorities had failed to meet the burden of proof showing that the transfer pricing between IRECO and the taxpayer in 2009 was not at arm’s length, nor was there proof of gratuitous and advantageous benefits for the purpose of article 26 of the ITC.

5.3. Rejection of the carry-over of previous losses

Finally, the Court of Appeal also rejected the tax authorities’ refusal to allow the carry-over of previous losses. The Court noted that the rejection of previous losses in a tax year cannot be justified by the claim that the taxpayer had foregone taxable income in previous tax years. It was against the law to “recuperate” foregone income that had been untaxed in previous tax years by means of a rejection of the carry-over of losses to which the taxpayer was duly entitled.

For these reasons, the Court of Appeal rejected the appeal by the tax authorities.

6. Observations on the Court’s Decision


The Court of Appeal came to the right conclusion with regard to the status of the DEMPE function analysis in the OECD Guidelines (2017). The new guidelines should not determine the outcome of a transfer pricing dispute relating to facts that took place in 2009. The OECD Guidelines are deemed not to have direct effect in Belgium and new additions post-factum are only relevant to the extent they clarify what was written in the version in force when the facts took place. In the case at hand, this was the 1995 version of the OECD Guidelines. The Court found support for this view in the tax authorities’ own admin-

13. See para. 6.90 OECD Guidelines.
It is regrettable that the Court of Appeal did not elaborate on the exact status of the OECD Guidelines in the Belgian legal order. Like the OECD Model and Commentary, the OECD Guidelines are the subject of a recommendation by the OECD Council to its members. Recommendations are not legally binding but represent the political commitment to the principles they contain and entail an expectation that adherents will do their best to implement them. Belgium tends to be a loyal adherent and typically applies the OECD Guidelines as and when they are published. In the aftermath of the adoption of new OECD Guidelines, the Belgian tax authorities usually issue administrative guidelines that transpose the OECD Guidelines updates into the domestic legal order. But even without the underpinning of a specific administrative guideline, the Belgian tax authorities tend to toe the OECD line in practice.

A separate issue is the temporal scope of application of new sections in updated versions of the OECD Guidelines, like the DEMPE function analysis in the OECD Guidelines (2017). To address this issue, it is needed to clarify the relationship between the OECD Guidelines and the OECD Model and Commentary. The generally shared opinion in the doctrine, which is also expressed in the Commentary on Article 9 of the OECD Model, is that the OECD Guidelines are to be seen as an extension of the Commentary on the OECD Model. This means that, depending on the position of the national court on the matter, the OECD Guidelines tend to share the same fate as the OECD Commentary with regard to its qualification as a means of interpretation in articles 31 or 32 of the Vienna Convention on the Law of Treaties, and with regard to the question whether a static or an ambulatory interpretation approach has to be adopted.

Belgian courts tend to be supportive of ambulatory interpretation (also called “dynamic interpretation”) where a tax treaty refers to domestic law and the domestic law has evolved after the signing of the treaty. In case of post-treaty changes in the OECD Commentary, courts have been more reluctant. No relevant prior jurisprudence seems to exist in which the same issue has been considered in function of the OECD Guidelines. The cautious approach taken by the Court of Appeal in Ghent with regard to the amending of the OECD Guidelines is perfectly in line with this general reticence. However, if one agrees that the OECD Guidelines are merely an extension of the Commentary on Article 9 of the OECD Model, to which the relevant provision in the tax treaty was modelled, an amending use of the new OECD Guidelines is not unfeasible, even if the Guidelines contain fundamental changes, as long as the text of the model provision for which they provide guidance has not been amended.

The Court of Appeal backs up its position supporting static interpretation by referring to the tax authorities’ administrative guideline issued in 2020 on the OECD Guidelines (2017). The administrative guideline provides that “although other methods are conceivable for achieving such a division [of MNE profits amongst its group companies], the Belgian tax authorities endorse the principles of the OECD Guidelines (2017).” In the final section on “entry into force” of the administrative guideline, it is stated that its provisions – including those provisions transposing chapter VI of the OECD Guidelines (2017) – are applicable on transactions between associated enterprises that take place as of 1 January 2018. The administrative guideline adds that “for transactions taking place before this date, both taxpayer and tax authorities are to rely on the guidance in force at that time, including the international standards.”

16. See, for example, BE: Administrative Guideline (Circular) 2020/C/35 of 25 February 2020, which transposes the changes introduced in the OECD Guidelines.
17. See OECD Model Tax Convention on Income and on Capital: Commentary on Article 9 para. 1 (21 Nov. 2017), Treaties & Models IBFD.
18. One notorious exception is the position taken by the Australian Federal Court in the SNF case. After the SNF case, the Australian Parliament resorted expressly to enact in express terms that, for the purposes of Australia’s domestic transfer pricing rules, the arm’s length conditions for an entity are to be consistent with the OECD Guidelines. See M. Kobetsky, The Status of the OECD Transfer Pricing Guidelines in the Post-BEPS Dynamic, 3 Intl Tax Stud. 2, secs. 4.2 and 4.4 (2020), Journal Articles & Opinion Pieces IBFD, and AU: FFC, 1 June 2011, [2011] FC AFC 74, Commissioner of Taxation v. SNF (Australia) Pty. Ltd., Case Law IBFD.
19. It has been argued elsewhere that the OECD Guidelines could anyhow not have been applied in the case at hand because the application would entail a violation of the overriding principle of the Belgian legal framework of the non-rectroactivity of (tax) law. This argument falters however by the fact that without a formal act of Parliament incorporating the OECD Guidelines into law, the OECD Guidelines do not have the status of law and merely remain an aid of interpretation for the application of the pre-existing legal provisions. See B. Markey & R. Devroye, “Back to the future?” – Belgian Court rules that DEMPE concept cannot be applied retroactively: Kluwer International Tax Blog (13 Sept. 2021), available at http://kluwer.taxblog.com/2021/09/13/back-to-the-future-belgian-court-rules-that-dempe-concept-cannot-be-applied-retroactively/ (accessed 7 Dec. 2021).
22. The doctrine generally disagrees with this point of view. Wattel & Marres (2003) and Ault (1994) all believe that relying on revised OECD Commentary is warranted as long as the revisions mostly contain clarifications. If revisions completely reverse the meaning of a treaty provision, then they do indirectly amount to an amendment of the treaty. See Hugh J. Ault, The Role of the OECD Commentaries in the Interpretation of Tax Treaties, Intertax 4, p. 143 (1994), P1 Wattel & O. Marres, The Legal Status of the OECD Commentary and Static or Ambulatory Interpretation of Tax Treaties, 43 Eur. Taxr. Taxn. 7 (2003), sec. 2.4.9 All depends, however, on what is considered to be a complete reversal of the meaning of the treaty provision. Illustrative in this regard is the generally accepted status of revision of the OECD Model Commentary: Commentary on Article 7 in 2008: all changes in the Commentary except the ones that were contrary to the previously and expressly endorsed interpretations by the OECD were deemed within the realm of interpretation of the new OECD Guidelines. The Belgian courts tend to be supportive of amending interpretation (also called “dynamic interpretation”) where a tax treaty refers to domestic law and the domestic law has evolved after the signing of the treaty. However, if one agrees that the OECD Guidelines are merely an extension of the Commentary on Article 9 of the OECD Model, to which the relevant provision in the tax treaty was modelled, an amending use of the new OECD Guidelines is not unfeasible, even if the Guidelines contain fundamental changes, as long as the text of the model provision for which they provide guidance has not been amended.
In the Belgian legal order, administrative guidelines like the one in question are considered non-normative instruments and they do not have binding effect on legal subjects/taxpayers. These instruments only bind civil servants – the tax authorities in this case – who are under the hierarchical authority of the competent minister. In tax matters, administrative guidelines serve the purpose of providing guidance to the subordinate tax authorities on the interpretation of tax law as it currently stands. Courts, however, interpret and apply statutory tax law only, and if the administrative guideline contains provisions that are contrary to the law, they will leave the guideline without effect. In the case at hand, this means that the Court of Appeal could have resorted to ambulatory interpretation if it considered this appropriate, but the fact that it is the tax authorities who claim ambulatory use of the OECD Guidelines (2017) and not the taxpayer is what settles the issue, without the Court having to make its own discretionary decision on the matter.

One final noteworthy aspect with regard to the administrative guideline in question is its seemingly innocent reference to the Vienna Convention on the Law of Treaties. In the introductory paragraphs of the guideline, it is provided that in relation to the OECD Guidelines (2017), “reference should be made to article 31 of the Vienna Convention on the Law of Treaties”. This is a controversial statement, given that the OECD Guidelines, like the OECD Model and Commentary, are not easily framed within article 31. These instruments are not part of the preparatory work of a pre-dating treaty, nor do they relate to the circumstances of the conclusion of such a treaty (article 31(1) and 31(2)). They are also not a subsequent agreement, as governmental delegates at the OECD who deliberate on the adoption of new guidelines cannot be equated to the contracting states, for lack of democratic legitimacy (article 31(3)(a)). For the same reason, the OECD Guidelines can also not be classified as subsequent state practice (article 31(3)(b)) or as a rule of international law applicable between the parties (article 31(3)(c)).

On the contrary, if the OECD Guidelines (2017) would fit into any of the categories of means of interpretation in article 31 of the Vienna Convention, there would be no doubt regarding their ambulatory effect: means of interpretation are generally not restricted in their temporal scope of application. As such, the reference to article 31 of the Vienna Convention is itself contradicting the rules set out in the administrative guideline on its temporal scope of application.


Although the Court of Appeal had already concluded in the first part of its decision that the only relevant version of the OECD Guidelines in the case at hand was the 1995 version, the judges seemingly could not resist to test some of the tax authorities’ application of the 2017 OECD Guidelines in the case at hand, even if this application was not admissible. And understandably so: the facts of this case lend themselves remarkably well for an application of some of the new rules in chapter VI of the OECD Guidelines (2017). Below, a hypothetical exercise is made in which the new rules are applied as if there were no restrictions regarding their application scope ratione temporis.

6.2.1. First pricing correction: 1998 agreement between the taxpayer and Dutch group company regarding the entitlement to the patent ownership rights

The industrial design and patent that are the focal point of this case are an example of what the OECD Guidelines (2017) describe as a self-developed intangible, created through small research and development expenditures but resulting in a highly valuable patentable invention. Furthermore, some of the elements in the case, like the fact that the intangible was only developed at the time of the transfer and the fact that the patent was later on transferred to another associated enterprise for a lump-sum payment, are indicative of what the OECD Guidelines (2017) refer to as an HTVI. The patent in question fulfils the two conditions to be classified as such, given that (i) there seemed to be no reliable comparables with regard to the transfers of the patent (as far as is known from the decision); and (ii) at the time of these transfers, projections on future cash flows or value of the intangible were highly uncertain. The qualification as an HTVI is important, given that the OECD Guidelines (2017) suggest that, for the purpose of testing the arm’s length principle nature of the intra-group transfer of an HTVI, any information asymmetries between taxpayer and tax authorities regarding what information the taxpayer took into account in determining the pricing of the transaction might be solved by allowing the tax authorities to consider ex-post profit levels or valuations as presumptive evidence of ex-ante pricing arrangements.

In the case at hand, the tax authorities’ pricing correction of the 1998 agreement was rejected because their claim of a lacking price adjustment clause had not been supported with evidence of unrelated-party practice. Under the new rules, the tax authorities could have ignored this last aspect and could have focused on the fact that in 2000, the patent was valued at EUR 3 million and in 2007 at EUR 731.5 million and whether these ex-post outcomes had been sufficiently anticipated and reflected in the agreement. The only way for the taxpayer to rebut the use of such “hindsight is 20-20” evidence would then be to provide details of the ex-ante projections used for the pricing arrangement of the transfer or to provide evidence of the unforeseeable developments or events occurring after the tax authorities’ DEMPE Function analysis.

26. See, in the same vein with regard to the legal status of the OECD Commentary: P.J. Wartel & O. Marres, supra n. 22, at sec. 2.4.
27. See para. 6.19 OECD Guidelines.
28. See id., at para. 6.190.
29. See id., at para. 6.189.
30. See id., at para. 6.191.
after the transfer and their probability of occurrence.\textsuperscript{31} In the case at hand, this evidence could for instance consist in the anticipation of the low probability that the design could successfully be patented in all relevant markets or the low probability of successfully protecting the patents once they had been obtained. All of these would justify a lower pricing in 1998 compared to a pricing that would be in proportion with the effective value increase of the patent over the next 10 years.

6.2.2. Second pricing correction: DEMPE function analysis

The second pricing correction undertaken by the tax authorities relates to the remuneration of the DEMPE functions carried on by the Belgian taxpayer, or more specifically, the lack of remuneration. The tax authorities’ analysis and the Court’s response illustrate some of the tensions inherent to the new rules under chapter VI of the OECD Guidelines (2017).

6.2.2.1. Development functions: Substance over form and remuneration based on ex-post profitability

The OECD Guidelines (2017) provide that the determination of the pricing of DEMPE functions entails a six-step process: after identification of the intangible (step 1); identification of the contractual arrangements regarding the ownership of the intangible within the group (step 2); and identification of the DEMPE function analysis (step 3); consistency between contractual arrangements and the effective performance of functions needs to be checked (step 4); and actual controlled transactions regarding the DEMPE of the intangible in relation to the legal owner within the group are to be delineated (step 5). In a final step (step 6), arm’s length prices for these transactions need to be determined.\textsuperscript{32} Like in the case of the pricing of the transfer of an intangible to related enterprises, also for the pricing of DEMPE contributions to the value of an intangible, the OECD Guidelines allow for ex-ante remuneration of the expected value of DEMPE functions to be reconsidered in function of ex-post profitability of the intangible.\textsuperscript{33}

DEMPE functions are however carried on throughout the lifespan of an intangible and not necessarily simultaneously. For instance, “development” necessarily precedes “enhancement” and “protection”. As such, framing all relevant DEMPE functions of an intangible is not necessarily possible in a moment-in-time snapshot of the contractual arrangements and functions, as required in the third and fourth of the six-step process. The way to deal with this issue seems to depend on one’s embrace of the substance-over-form restatement of the arm’s length principle in the OECD Guidelines (2017).

The determination of the remuneration of the “development” functions in the case at hand is illustrative in this regard. The crux of the matter is not who carried out these functions – it was the taxpayer – but how this attribution of functions fitted in the one-time snapshot of the contractual arrangements. The Belgian tax authorities demanded proper remuneration based on ex-post profitability of the development functions carried on by the taxpayer in 1996 to 1998 in relation to the patented design formula. This required however making abstraction of the fact that (i) these functions had been remunerated under the transfer agreements in 1998 and in 2001; and the fact that (ii) there was no formal legal relationship with regard to the development activities in the relevant tax year, 2009, between the taxpayer and the current legal owner of the patent.

For the Court of Appeal, such a far-fetched application of the substance-over-form approach to the arm’s length principle was apparently a bridge too far. The Court refused to question the arm’s length nature of the relationship between the taxpayer and the Dutch group company to which the former had surrendered any ownership rights to the invention. The Court settled the discussion by pointing out that, in any case, ex-post considerations of ex-ante pricings of past DEMPE functions can only go back in time as far as the legal prescription terms allow. In the case of the Belgian tax procedure, the term is 7 years after the year in which the taxable event took place, which made it impossible to reassess the development activities that took place between 1996 and 1998.

6.2.2.2. Protection functions: Subcontracting to related entities

From the facts of the case, it is clear that the “protection” of the patent in question in the years directly preceding the relevant tax year was a key driver of its value. Being easy to reverse engineer and incorporate in mass production, the successful licensing activity undertaken by the group depended heavily on the aggressive pursuing of infringement claims. Unlike in the case of the development, here the crux of the matter is the identification of the group entity that performed these functions. Again, the answer depends on the degree of embrace of the substance-over-form restatement of the arm’s length principle.\textsuperscript{34}

The protection functions consisted of three separate activities: the prospecting and contacting of potential licence holders, the negotiations of licence agreements, and the offensive and defensive pursuing of patent infringements. For the purpose of these activities, the owner, IRECO, relied on its employees, but some of these were also employed by BELSERCO, a second Belgian group company besides the taxpayer. It also relied on subcontractors in the form of a subsidiary set up by IRECO for this exact purpose in Ireland. This subcontractor pursued patent infringement claims and relied for this purpose on

\textsuperscript{31} See id., at para. 6.193.

\textsuperscript{32} See id., at para. 6.34.

\textsuperscript{33} See id., at paras. 6.69 and 6.186.

\textsuperscript{34} The substance-over-form approach should not be confused with disregard of the separate legal entities. As observed by the Court of Appeal, (see section 5.2.2.) disregarding legal personality requires application of the general anti-abuse rules. For the purpose of determining who undertook the DEMPE functions, substance over form implies that form is trumped by substance to the extent that a DEMPE function is not attributed to an entity because it formally carries out said function, but because the entity assumes and controls the risk and effectively disposes of the assets to perform the function.

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Even if one accepts the scholarly view that the arm’s length principle has always been an anti-avoidance rule as much as a rule to solve double economic taxation and that the new rules are simply a restatement of what was always inherent in article 9 of the OECD Model, one has to accept that the practical consequences of the new rules make ambulatory use of the new rules a stretch of what is acceptable. In the case at hand, the Belgian Court of Appeal shared this view but was helped a great deal by the fact that the Belgian tax authorities were bound by the endorsement of static interpretation in Administrative Guideline 2020/C/35 of 25 February 2020. Similar outcomes on this issue are expected to be witnessed in other countries. Generally speaking, this means that it will take a while before judgments will be released in which courts around the world consider the merits of individual case DEMPE function analyses.

Eventually, however, DEMPE will hit the courts and not in small numbers. This case shows that given the often complex structure of MNEs with directors and employees performing multiple roles in different legal capacities for various group companies, it is not a mean feat to determine whether functions performed, assets used and risks assumed in connection with DEMPE of intangibles are properly recognized and remunerated in accordance with the arm’s length principle. The decision by the Belgian Court of Appeal shows that functional analysis depends on one’s embrace of the new substance-over-form approach of the OECD Guidelines (2017). Different courts might have different views in this regard.

It is believed that the OECD Guidelines (2017) could do with some additional pointers on the limits of a substance-over-form approach regarding DEMPE functions. Additional clarification will serve not just to rein in tax authorities’ reassessment powers like in the case at hand, but also to avoid taxpayers venturing into DEMPE tax arrangements that lack evidence of commercial rationality or substance, but without venturing into the realm of dedicated anti-abuse provisions. Future litigation and court decisions on the matter will be of great relevance in this regard.

On a final note, it is worth reflecting that in the case at hand, the Belgian tax authorities based their reassessment of the taxpayer’s profits on article 26 of the ICT, and not on article 185(2), which incorporates the language of article 9 of the OECD Model into Belgian law. Article 185(2) was introduced in 2004 with the explicit purpose to give the arm’s length principle a proper foundation in Belgian tax law. However, unlike statutory provisions, notions like the arm’s length principle and the way how they are manifested in practice evolve over time. It is fair to say that with its wide scope and focus on commercial rationality, not article 185(2) but the old article 26 and its doctrine of “abnormal and gratuitous” advantages is most apt to catch the OECD’s new vision of the arm’s length principle as expressed in chapter VI of the OECD Guidelines (2017).

7. Final Thoughts

The DEMPE function analysis has been introduced in the OECD Guidelines (2017) for the purpose of taxing value where value is created. Tax authorities are keen to apply the analysis in practice. The case at hand shows that this is not a problem-free endeavour.

First of all, many courts will be reluctant to apply the new DEMPE rules in relation to taxable events that took place before the adoption into the OECD Guidelines (2017). Even if one accepts the scholarly view that the arm’s

35. See para. 6.51 OECD Guidelines.
36. See id. at para. 6.53.
37. See id. at para. 6.66.