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## Comparative Analysis of Transfer Pricing Legislation in the Regulatory Framework of EU Member States

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**Abstract.** *The article carries out a comparative analysis and assessment of the adequacy of legal regulation of transfer pricing in the EU Member States. The necessity and importance of studying foreign experience in building and improving the legal framework for transfer pricing is substantiated. The authors determine that the relevance of transfer pricing and related issues both in terms of ensuring the proper functioning of the single market and eliminating base erosion and profit shifting is confirmed by the existence of a special advisory body under the European Commission – the Joint Transfer Pricing Forum (JTPF), which advises the European Commission on transfer pricing taxation. The article identifies the main aspects of transfer pricing regulation in the EU Member States with a view to a detailed analysis of the regulatory framework. The criteria of related parties in the EU transfer pricing legislation are studied. It is found that a common feature in the definition of related parties is the direct or indirect influence of one person on another. The author examines and compares the grounds for conducting an audit in the EU transfer pricing legislation and finds that in the vast majority of EU Member States there is a so-called "self-assessment" regime for companies, according to which the taxpayer must ensure compliance with the transfer pricing rules; the risk factors that are relevant for conducting an audit of transfer pricing transactions are legally defined; common factors for the sample of countries studied are: unprofitability of a group of companies against the background of profitability of other entities. It is concluded that the studied foreign experience of regulatory and legal regulation of transfer pricing transactions on the example of individual EU Member States has shown a high level of unification of legislation in the field of transfer pricing, with minor differences in the provisions of the national legal framework; the differences are mainly in the systematic nature of determining the criteria of relatedness of parties in transfer pricing transactions and the grounds for conducting audit procedures on such transactions.*

**Keywords:** *transfer pricing, relatedness criteria, audit of transfer pricing transactions, foreign experience, legislative framework.*

**JEL Classification:** *E64, F23, F65, H25, H26, H32, K34, M42*

## 1 Introduction

The constant revision of transfer pricing legislation, the involvement of business representatives and tax advisors in discussions on the state of transfer pricing regulation, and numerous controversial court cases all comprehensively demonstrate the different levels of development of transfer pricing regulation systems in different countries. Several authors have studied the foreign practice of transfer pricing regulation and its peculiarities. At the same time, the importance of studying foreign experience in this area is confirmed by the publication activity on this topic abroad. Therefore, given that the system of regulatory and legal regulation of transfer pricing transactions in Ukraine is in the process of active improvement.

In view of the prospect of Ukraine's membership in the European Union and in order to identify the most valuable experience in terms of borrowing and implementing it in domestic practice, it is necessary to conduct a general review and analysis of the state of development of transfer pricing legal regulation in developed EU countries.

The purpose of the study is to examine the general imperatives of the legal and regulatory framework for transfer pricing in the EU Member States. This goal can be achieved through the following tasks:

- To provide a general assessment of the legal and regulatory framework for transfer pricing in the EU countries;
- to systematise the related party criteria in the EU transfer pricing legislation;
- to summarise the grounds for audit in the EU transfer pricing legislation.

The following methods were used to achieve the research objective and to fulfil the research tasks: analysis and synthesis to study and summarise the legal framework of transfer pricing regulation in the EU; comparative legal analysis to compare the criteria for related parties and the grounds for conducting an audit in different EU countries; induction and deduction to form a general picture of the legal regulation of transfer pricing and to systematise the data obtained; empirical method to collect and analyse the data obtained. These methods allowed a comprehensive study and relevant results on the legal regulation of transfer pricing in EU countries.

## 2 General Assessment of the Legal Framework for Transfer Pricing Regulation in the EU

The problems caused by transfer pricing in the EU tax system were first identified in 2001 by the European Commission (Commission of the

European Communities). This was the impetus for the establishment of the EU Joint Transfer Pricing Forum (JTPF), which was set up to advise the European Commission on the tax aspects of transfer pricing (Joint Transfer Pricing Forum). The JTPF works within the framework of the OECD Transfer Pricing Guidelines and on a consensus basis to develop pragmatic, non-legislative solutions to practical transfer pricing problems in the EU. The work of the JTPF is based on two main areas: the Arbitration Convention is a special mechanism for resolving transfer pricing disputes and other transfer pricing issues identified by the JTPF and included in its work programme (Joint Transfer Pricing Forum). The JTPF consists of one representative from each Member State's tax administration and 18 members from non-governmental organisations, and is chaired by an independent chairman. As part of its work, the forum identified several important issues in the field of transfer pricing, namely:

- Work on practical issues arising from country reports and transfer pricing documentation;
- the use and improvement of comparable data and methods within the EU;
- economic evaluation methods applicable to transfer pricing in the EU;
- inventory, review and assessment of the state of multilateral transfer pricing control in the EU;
- assessing practical issues related to the use of profit sharing in the EU once the OECD conclusions are available;
- internal monitoring and control of the functioning of the dispute resolution system and Advance Pricing Agreements (APAs) in the field of transfer pricing (Joint Transfer Pricing Forum).

Thus, the relevance of transfer pricing and related issues (both to ensure the proper functioning of the single market and to eliminate tax base erosion and profit shifting) is confirmed by the existence of a special advisory body under the European Commission – the Joint Transfer Pricing Forum (JTPF), which advises the European Commission on transfer pricing taxation.

Considering the areas of activity of the Joint Fund, it can be said that although transfer pricing regulation in the EU countries is carried out within the European legal framework, it also has differences by country. The study of the experience of EU member states in the field of transfer pricing regulation will be systematically conducted in the following aspects:

- National legislation on transfer pricing;
- references to the OECD Guidelines in national legislation;

- criteria and approaches to determining the relatedness of parties;
- applicable transfer pricing methods;
- regulated transfer pricing reporting and documentation;
- special audit procedures and penalties in the field of transfer pricing.

A summary of the results of the analysis of the above issues in the context of the 27 EU Member States is presented in Table 1.

The arm's length principle is applied by all EU Member States. At the same time, it should be noted that Ireland, for example, does not have specific transfer pricing rules. The national legislation of Ireland, Greece, Slovenia, Latvia, Luxembourg and Poland does not contain an explicit reference to the OECD Guidelines. However, their transfer pricing legislation and tax authorities generally follow the arm's length principle and the methods set out in the OECD Guidelines. In most Member States, the OECD Guidelines have been published in administrative regulations or adopted as official rules (as in Austria). In Lithuania, the OECD Guidelines have been implemented in transfer pricing legislation. All EU Member States except Austria have a statutory definition of related parties in their national legislation, which is generally in line with the provisions of Article 9 of the OECD Model Tax Treaty. Austrian law does not contain a specific definition of related parties. Estonian tax legislation, on the other hand, provides a rather broad definition of a related party. In addition, Portuguese tax legislation contains a comprehensive definition of related parties (associates). According to the full and broad definition of related parties adopted in the

Slovak Republic, all entities of a group are related parties. Each Member State applies transfer pricing methods based on the general recommendations of the OECD Guidelines. Most Member States explicitly specify in their national legislation the transfer pricing methods to be used for international pricing. Other Member States make explicit reference to the OECD Guidelines. All Member States except Ireland apply general rules on transfer pricing documentation. However, taxpayers in Ireland are required to keep documentation in order to be able to justify the transfer prices determined as fair in the event of a transfer pricing audit. Latvia is still in the process of implementing documentation requirements and therefore taxpayers and tax authorities currently rely on the recommendations of the OECD Guidelines. In most Member States the documentation requirements were published in administrative regulations and were based on the recommendations of the OECD Transfer Pricing Documentation Guidelines. Only in the Slovak Republic have the tax authorities started to carry out special tax audits on transfer pricing. In the Slovak Republic, there is a specialised group of tax office staff that conducts transfer pricing audits. Belgium has also set up a specialised transfer pricing audit team consisting of 8 on-site auditors and 1 support staff. Belgium has also issued administrative instructions on transfer pricing audits and documentation. Spain's Corporate Income Tax Law sets out the basic principles of a specific transfer pricing audit procedure. Special penalties for transfer pricing are applied in the following countries: Germany, France, Slovenia, Denmark, Greece, Finland, the

**Table 1** Aspects of transfer pricing legislation in EU Member States

№	Aspect of transfer pricing regulation	Number of countries	
		where the aspect is regulated	where the aspect is not regulated
1	Provisions of national legislation in the field of transfer pricing	27 countries (all EU Member States)	–
2	References to the OECD Guidelines in national legislation	21 countries	6 countries (Greece, Ireland, Latvia, Luxembourg, Poland, Slovenia)
3	Criteria and approaches to determining whether parties are related	26 countries	1 country (Austria)
4	Applicable transfer pricing methods	27 countries (all EU Member States)	–
5	Regulated transfer pricing reporting and documentation	25 countries	2 countries (Ireland, Latvia)
6	Special audit procedures and transfer pricing penalties	19 countries	8 countries (Austria, Estonia, Italy, Ireland, Latvia, Luxembourg, Portugal, Sweden)

Source: compiled by the authors based on Joint Transfer Pricing Forum

Netherlands, Hungary, Bulgaria and Romania. They are imposed for:

- Tax evasion, tax fraud, false information in tax returns (Germany);
- provision of incomplete information to the tax authorities (France);
- lack of supporting documents (Slovenia);
- difference between the established transfer prices and market prices (Greece, Lithuania, Bulgaria, the Netherlands);
- non-compliance with documentation requirements (Hungary);
- failure to provide a file of transfer pricing documentation (Romania).

Thus, it can be concluded that the most unified provisions of the EU Member States' transfer

pricing legislation are the criteria for determining the relatedness of parties and special procedures for reviewing transfer pricing transactions.

### 3 Related Party Criteria in EU Transfer Pricing Legislation

Approaches to the legislative definition of related parties in individual EU Member States are systematised in Table 2.

For the purpose of comparability of certain provisions, countries have been divided into informal economic and political associations. Thus, a common feature in determining the relatedness of parties is the direct or indirect influence of one party on the other. Some countries, such as Luxembourg, do not define their own specific related party criteria

**Table 2** Legislative approaches to defining the criteria for related parties in selected EU Member States

Economic and political union	EU Member State	Approach to defining related party criteria
EU founding countries	France	Companies that depend on or control companies outside France
	Italy	Parties that directly or indirectly control or are controlled by an Italian entity, or are controlled by the same company that controls the Italian entity
	the Netherlands	An entity has an interest, directly or indirectly, in the management, control, or equity of another entity, or an entity has an interest, directly or indirectly, in the management, control, or equity of both the first and second entities
The Benelux	Belgium	The party is related to the other party through direct or indirect control
	Germany	A party holds a quarter of the share, directly or indirectly, in the authorised capital, is entitled to a quarter of the profits or liquidation estate; may exercise control, directly or indirectly; other cases
	Luxembourg	The definition is consistent with the definition in Article 9(1) of the OECD Model Tax Convention on Income and Capital Taxes
The Baltic States	Latvia	Two or more individuals or legal entities (except for business entities whose relations are based on shares or stock directly owned by the state or local self-government bodies) or a group of such entities that are contractually related, or representatives of such entities or group, provided that at least one of the following conditions is met
	Lithuania	The parties are related parties and can influence each other, which may result in the terms of their mutual transactions or business operations differing from those in which each party seeks to maximise its economic advantage
	Estonia	The parties have a common business interest, or one party has a dominant influence over the other party
The Visegrad Group	Poland	Entities in which one entity has significant influence over at least one other entity; or entities that are significantly influenced by such entities or individuals
	the Czech Republic	Parties that are related through equity (directly or indirectly); parties that are otherwise related (based on certain criteria)
	Hungary	A taxpayer and a person who has greater control over the taxpayer, directly or indirectly; a taxpayer and another person, if the third party has greater control over both the taxpayer and such other person, directly or indirectly, etc.
	Slovakia	A close relative; an individual or legal entity related by economic, personal or other relationships; an individual or legal entity that forms part of a consolidated entity for consolidation purposes

Source: compiled by the authors based on Transfer Pricing Country Profiles

in national legislation, referring to the OECD Model Tax Convention on Income and Capital. Instead, other countries (the Netherlands, Latvia, Hungary) provide an extensive list of related party criteria. In authors' opinion, Slovakia has the most comprehensive list of related party criteria in its legislation, which reduces the risk of proving the relatedness of parties in transfer pricing tax audits. This experience will be useful for the Ukrainian practice of improving the system of determining the relatedness of parties in controlled transactions.

#### 4 Grounds for Audit in EU Transfer Pricing Legislation

The experience of the EU countries in the field of transfer pricing audit is important and valuable for implementation in the domestic practice. The grounds for auditing transfer pricing transactions and unscheduled tax audits of such transactions in EU Member States are systematised in Table 3.

For example, many EU Member States have a "self-assessment" system for companies, which requires the taxpayer to ensure compliance with

**Table 3** Grounds for auditing transfer pricing transactions in EU Member States

Economic and political union	EU Member State	Grounds for conducting an audit of transfer pricing transactions
EU founding countries	France	"Risky" business models; licence fees to low-tax jurisdictions; fixed costs of a "low-risk" enterprise; business restructuring
	Italy	"Unusual" internal costs, paid and contract production, commission and agency activities; "high-risk" business models
	the Netherlands	High-risk business models; limited-risk distributors and contractual services; recurring losses; payments related to intangible assets such as licence fees, royalties and cost-sharing agreements; payments to low-tax jurisdictions; business restructuring
The Benelux	Belgium	Repeated losses; losses in "low-risk" companies; licence fees to low-tax jurisdictions; financial transactions; management fees; transactions with tax haven companies where there is no or little economic value in those countries or where payments are made directly or indirectly to such companies; business restructuring
	Germany	Ongoing loss-making (more than 3 years in a row); business restructuring / transfer of functions; financial transactions; management fees / headquarters services / cost sharing; transfer and licensing of (difficult to value) intangible assets; lack of analysis and documentation; controlled transactions with low-tax jurisdictions / blacklisted countries, business restructuring
	Luxembourg	Loans to other group companies; interest rates on intercompany loans; licence fees; business restructuring
The Baltic States	Latvia	Large taxpayers; permanent losses for local businesses; licence fees to low-tax jurisdictions; business restructuring
	Lithuania	Recurring losses, especially in low-risk companies; payments to tax havens and/or low-tax jurisdictions; high related party expenses (management fees, interest, royalties, etc.)
	Estonia	Certain types of transactions, the related party's location in a tax haven, the company's high credit burden, as well as insufficient documentation and unwillingness to cooperate
The Visegrad Group	Poland	Companies that have incurred losses for several years, in particular, "low-risk" companies; losses incurred by local companies but overall group profits; companies that pay large management fees or royalties or other payments for the use of intellectual property; significant group reorganisations involving the transfer of business or intellectual property abroad; tax haven transactions
	the Czech Republic	Long-term loss-making status of contract manufacturing companies (especially manufacturers), situations where the functional profile of the company does not correspond to its profitability, provision of various intra-group royalties for services and financing
	Hungary	Application of a sectoral approach to transfer pricing tax audits; constant generation of losses; high intercompany payments
	Slovakia	Losses of companies with limited risk, situations where the functional profile of the company does not correspond to its profitability, provision of various intra-group services, royalties and financing

Source: compiled by the authors based on *Global Transfer Pricing Guide*

**Table 4** Compliance of the legislative and regulatory framework on transfer pricing in Ukraine with EU legislation

№	Aspect of transfer pricing regulation	Characteristics
1	Provisions of national legislation in the field of transfer pricing	Provided for by the Tax Code of Ukraine, other regulatory and legislative acts on transfer pricing
2	References to the OECD Guidelines in national legislation	The main provisions of the OECD Guidelines are implemented in the Tax Code of Ukraine
3	Criteria and approaches to determining whether parties are related	Defined in the national accounting legislation, specified in the Tax Code of Ukraine, fragmented in letters from the Ministry of Finance and the State Tax Service
4	Applicable transfer pricing methods	Follow the list of transfer pricing methods according to the OECD Guidelines
5	Regulated transfer pricing reporting and documentation	National reporting system (separate reports), as well as a three-tiered documentation model in accordance with the OECD Guidelines
6	Special audit procedures and transfer pricing penalties	The law defines the list of grounds for documentary audits and control over transfer pricing, imposes fines for failure to submit (late submission) of a report on controlled transactions, failure to submit (late submission) of documentation, failure to comply with the arm's length principle, etc.

Source: compiled by the authors based on *Global Transfer Pricing Guide*

transfer pricing rules. At the same time, the law defines risk factors to be taken into account in the audit of transfer pricing transactions. Common factors for the sample of countries under review are the unprofitability of a group company against the background of the profitability of other companies, business models of high-risk transactions, transfer of functions and functional areas, transactions with residents of low-tax jurisdictions (tax havens), corporate restructuring, etc. The experience of Hungary is interesting, where the tax authorities apply a sectoral approach when preparing tax audit plans and transfer pricing audits, having previously identified a list of industries in which related parties engage in potentially risky tax base erosion transactions.

### 5 Conclusions

Thus, the reviewed experience of the most unified legislative aspects of transfer pricing in the EU countries will serve to assess its suitability for the legal framework of the Ukrainian transfer pricing. A general assessment of the compliance of

the Ukrainian transfer pricing legislation with the EU legal framework is presented in Table 4.

The analysis of the legislative and regulatory framework on transfer pricing in Ukraine shows that its provisions are in line with the EU legal environment. In authors' opinion, the issue of the grounds for conducting transfer pricing audits and unscheduled tax audits of such transactions needs to be improved.

Thus, the studied foreign experience of regulatory and legal regulation of transfer pricing transactions on the example of certain EU Member States has shown a high level of unification of legislation in the field of transfer pricing with minor differences in the provisions of the national regulatory framework. The differences mainly lie in the systematic approach to determining the criteria for determining whether the parties are related in transfer pricing transactions and the grounds for conducting audit procedures in such transactions. As the transfer pricing legislation in Ukraine is constantly being improved, this experience will be useful in the context of implementing the best legislative practices.

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