WIRTSCHAFTS
UNIVERSITÄT
WIEN VIENNA
UNIVERSITY OF
ECONOMICS
AND BUSINESS

EQUIS ACCREDITED AACSB ACCREDITED AMBA ACCREDITED

In Principle, (Im)possible: Harmonizing an EU Arm's Length Principle

Doeleman, Ruby

Published in:
EC Tax Review

Published: 01/04/2023

Document Version:
Publisher's PDF, also known as Version of record

Document License:
Unspecified

Link to publication

Citation for published version (APA):
Doeleman, R. (2023). In Principle, (Im)possible: Harmonizing an EU Arm's Length Principle. *EC Tax Review*, *32*(3), 93-102. https://kluwerlawonline.com/journalarticle/EC+Tax+Review/32.3/ECTA2023015

Download date: 16. May 2025

ec TAX REVIEW 2023–3

Article

In Principle, (Im)possible: Harmonizing an EU Arm's Length Principle

Ruby Doeleman[*]

The arm's length principle should maintain a tax-level playing field between multinational groups of taxpayers and standalone enterprises. Despite the fact that all EU Member States implemented an arm's length principle in their domestic transfer pricing rules, differences in the application of the arm's length principle remain. These differences create two challenges for the EU internal market. The first issue is a potentially unjustified restriction of the fundamental freedoms when the arm's length principle is only applied in a cross-border context, thereby impeding the free and competitive allocation of resources within the EU internal market and favouring domestic transactions. The second issue is that EU Member States can use the arm's length principle as a tax competition instrument through transfer pricing rulings that result in reduced tax liability, thereby potentially granting illegal State aid benefits. In light of these threats to the EU internal market, the subsidiarity and proportionality requirements could warrant harmonization of the arm's length principle. However, the fundamental nature of the arm's length principle as an open legal standard would render harmonization efforts less effective than intended.

Keywords: Arm's length principle, transfer pricing, OECD Transfer Pricing Guidelines, harmonization, subsidiarity and proportionality, State aid, Fundamental Freedoms, BEPS, tax abuse, Court of Justice of the European Union (CJEU), European Commission

1 INTRODUCTION

The EU Court of Justice's (hereinafter: CJEU) ruling in the Fiat Finance case[1] disqualified the notion that there is an arm's length principle inherent in EU State aid law. In this ruling, the CJEU annulled the General Court's (hereinafter: GC) judgement,[2] which supported the European Commission's decision,[3] that Luxembourg granted Fiat illegal State aid through deviating from the arm's length principle in its transfer pricing rulings. The takeaway from this ruling is that even though the arm's length principle is an internationally accepted standard in transfer pricing, without harmonization, it cannot be directly applicable as part of EU law.[4]

The unanimity requirement[5] in EU law regarding direct taxation suggests that the European Commission might try to influence the tax practices of the Member States[6] without legislation, with the goal of fighting harmful tax competition by Member States and aggressive tax planning by taxpayers.[7] The question of whether there exists an EU arm's length principle forms part of the greater question on 'harmonization through the backdoor'.[8] The possibility of such implicit harmonization increases legal uncertainty for both taxpayers and Member States, with only limited benefits for tax sovereignty, tax efficiency, and tax fairness.[9] From this standpoint, the CJEU's ruling in the Fiat case is redeeming.

Nonetheless, despite the CJEU's rejection of an inherent EU arm's length principle, it is worth asking whether EU legislation should harmonize the arm's length principle. Transfer pricing is of vital importance for the

[*] PhD candidate in the Doctoral Program in International Business Taxation at WU Vienna University of Economics and Business. The author acknowledges support by the Austrian Science Fund (FWF): Doc 92-G. Email: ruby.doeleman@wu.ac.at.

[1] CJEU, 8 Nov. 2022, joined cases C-885/19 P and C-898/19 P, *Fiat Chrysler Finance Europe and Ireland v. European Commission*, ECLI:EU:C:2022:859.

[2] GC 24 Sep. 2019, joined cases T-755/15 and T-759/15, *Grand Duchy of Luxembourg and Fiat v. European Commission*, ECLI:EU:T:2019:670.

[3] Commission Decision (EU) 2016/2326 of 21 Oct. 2015 on State aid SA.38375 (2014/C ex 2014/NN) which Luxembourg granted to Fiat (notified under document C(2015) 7152), *O-J* L 351.

[4] CJEU, 8 Nov. 2022, *supra* n. 1, para. 96.

[5] Art. 115 TFEU. I leave out of scope Art. 116 TFEU, which has never been used in the field of direct taxation. *See* J. Englisch, *Article 116 TFEU – The Nuclear Option for Qualified Majority Tax Harmonisation?*, 29(2) EC Tax Rev. 58–61 (2020).

[6] By 'Member States', I refer to the twenty-seven Member States of the European Union.

[7] A. P. Dourado, *Editorial: The FIAT Case and the Hidden Consequences*, 51(1) Intertax 2 (2023).

[8] For the term 'harmonization through the backdoor', *see* e.g., G. Allevato, *Judicial Review of the State Aid Decisions on Advance Tax Rulings: A Last Resort to Safeguard the Rule of Law*, 62(2) Eur. Tax'n 2 (2022); G. Perotto, *How to Cope With Harmful Tax Competition in the EU Legal Order: Going Beyond the Elusive Quest for a Definition and the Misplaced Reliance on State Aid Law*, 13(1) Eur. J. Legal Stud. 312 (2021); D. A. Kyriazis, *From Soft Law to Soft Law Through Hard Law: The Commission's Approach to the State Aid Assessment of Tax Rulings*, 15(3) Eur. State Aid L.Q. 436 (2016); E. Forrester, *Is the State Aid Regime a Suitable Instrument to Be Used in the Fight Against Harmful Tax Competition?*, 27(1) EC Tax Rev. 33 (2018); and C. Peters, *Tax Policy Convergence and EU Fiscal State Aid Control: In Search of Rationality*, 28(1) EC Tax Rev. 6 (2019).

[9] R. de la Feria, *Editorial: Pillar 2, Fiat, and the EU Unanimity Rule on Tax Matters*, 32(1) EC Tax Rev. 2 (2023).

© 2023 Kluwer Law International BV, The Netherlands

determination of multinational enterprises' profits and the international allocation of taxing rights among Member States, and the arm's length principle has become a widely accepted standard in transfer pricing practice. However, without a legal obligation to harmonize the arm's length principle, disparities in how Member States apply the principle remain.

Disparities in the application of the arm's length principle within the EU raise two fundamental issues. The first issue concerns the safeguarding of the EU fundamental freedoms: Can a difference in application of the arm's length principle in domestic and cross-border situations constitute a restriction of the right of establishment? Can this restriction be justified? The second issue concerns the granting of illegal State aid: Can transfer pricing rulings granted by Member States constitute illegal State aid when they deviate from the arm's length principle? Which arm's length principle? In addition, the differential application of the arm's length principle raises questions regarding the opportunities of tax abuse through aggressive tax planning: Do international disparities in the application of the arm's length principle leave scope for profit shifting through transfer pricing?

This article aims to address these questions and proceeds as follows. The background of the arm's length principle in pricing intra-group transactions its relationship with the EU fundamental freedoms and State aid is discussed (section 2). Subsequently, the disparities in the application of the arm's length principle in Member States' tax legislation and their sovereignty in direct taxation is discussed (section 3). This provides the starting point for assessing which problems could be addressed by harmonization of the arm's length principle (section 4). However, there are barriers to harmonization (section 5), which lead to the conclusion that the arm's length principle should not be harmonized at the EU level (section 6).

2 The arm's length principle

2.1 The Principle of Transacting at Arm's Length

The objective of the arm's length principle is two-fold: it allocates profits to individual taxpayers and taxing rights to jurisdictions.[10] The first objective allows the domestic determination of taxable profits for the calculation of a taxpayer's tax liability, in line with a fair attribution of income to group entities that diminishes the potential to engage in aggressive tax planning.[11] The second objective derives from the inclusion of the arm's length principle in the OECD Model Tax Convention, which allocates taxing rights with respect to associated enterprises in a way that prevents economic double taxation.[12]

Through both of its objectives, the arm's length principle is fundamental to the prevention of tax abuse through transfer pricing. Indeed, there is an inherent incentive for multinational groups to manipulate their transfer prices in order to shift taxable income to minimize the overall tax liability. By requiring arm's length pricing, artificial profit shifting and distorted competition between integrated and standalone enterprises should be prevented. The arm's length principle should thus ensure that whether or not a domestic enterprise is part of a multinational group does not influence its tax position.[13]

Because of its approximate nature, the arm's length principle constitutes an open legal standard. By requiring that prices should be comparable based on competitive conditions, the arm's length principle does not specify *how* such prices should be determined. This can be referred to as reflexivity in transfer pricing, which relies on the taxpayer completing procedural steps after an accurate delineation in line with the enterprise's value creation of the economic transaction for which the arm's length price should be determined.[14] As such, the arm's length principle grants responsibility to the taxpayer, but also introduces subjectivity.[15]

2.2 The EU Fundamental Freedoms and the Arm's Length Principle

A non-harmonized arm's length principle might generate a potentially unjustified restriction of the EU fundamental freedoms, namely if the application of the arm's length principle is limited to cross-border transactions. In domestic transactions, transfer pricing is not strictly required from the perspective of determining the domestic tax base, since there is no inherent risk of profit shifting and no need to allocate tax base to different jurisdictions.[16] Hence, in a non-cross-border setting,

[10] OECD TP Guidelines 2022, Preface, para. 7. *See also* W. Schön, *Transfer Pricing, the Arm's Length Standard and European Union Law*, in *Allocating Taxing Powers Within the European Union* 79–80 (I. Richelle, W. Schön & E. Traversa eds, Berlin Heidelberg: Springer-Verlag 2013); and R. Petruzzi, *The Arm's Length Principle: Between Legal Fiction and Economic Reality*, in *Transfer Pricing in a Post-BEPS World* 2 (M. Lang, A. Storck & R. Petruzzi eds, Alphen aan den Rijn: Kluwer Law International 2016).

[11] Petruzzi, *supra* n. 10, at 2.

[12] Art. 9 OECD Model Tax Convention. One issue that seems of relevance here is that a one-sided transfer pricing method does not guarantee complete profit allocation to both affiliated entities, *see* the Belgian excess profit rulings case GC 14 Feb. 2019, joined cases T-131/16 and T-263/16, *Kingdom of Belgium and Magnetrol International v. European Commission*, ECLI:EU:T:2019:91, resulting in double non-taxation. I leave this specific transfer pricing issue outside the scope of this article.

[13] Schön, *supra* n. 10, at 78.

[14] This term was introduced with respect to transfer pricing by C. Peters, *Critical Analysis of the General Court's 'EU Arm's Length Tool': Beware of the Reflexivity of Transfer Pricing Law!*, 31(1) EC Tax Rev. 30–39 (2022). The focus on value creation and accurate delineation was introduced in the OECD TP Guidelines through BEPS Actions 8–10.

[15] OECD TP Guidelines 2022, para. 3.46.

[16] S. Buriak & I. Lazarov, *Between State Aid and the Fundamental Freedoms: The Arm's Length Principle and EU Law*, 56(4) Common Mkt. L. Rev. 936 (2019). *See also* Opinion of A-G Bobek, 14 Dec. 2017, C-382/16, *Hornbach-Baumarkt-AG v. Finanzamt Landau*, ECLI:EU:C:2017:974, paras 56–69.

there is no legislative incentive to introduce transfer pricing for associated enterprises because all taxpayers are taxed domestically.[17]

However, even though restricting the application of the arm's length principle to cross-border transactions is understandable from the objectives of the arm's length principle. This favouring of domestic transactions might constitute discriminatory treatment that may be incompatible with the EU fundamental freedoms and that may threaten the free and competitive allocation of resources within the EU internal market. Previously, Member States have indeed been challenged on such discriminatory application of the arm's length principle.

In its case law, the CJEU connects the objectives of the arm's length principle to the prevention of profit shifting through transfer pricing.[18] The CJEU's starting point is economic reality, implying that enterprises should act under fully competitive conditions and provide commercial justifications for transactions that are not in line with the arm's length principle. Therefore, justification of discriminatory application of the arm's length principle connects the balanced allocation of taxing rights between Member States with efforts to prevent tax abuse.[19] This emphasizes the relevance of the arm's length principle as an anti-tax abuse instrument that safeguards a level playing field between standalone and integrated companies within the EU internal market.

2.3 State Aid and the Arm's Length Principle

Because the arm's length principle functions as an open standard and thereby creates legal uncertainty, transfer pricing rulings provide individual taxpayers with advance legal certainty on whether intra-group transactions are priced at arm's length.[20] However, if Member States conclude transfer pricing rulings that result in a lower tax liability, this may result in the granting of a selective advantage to taxpayers that qualifies as illegal State aid.[21] Indeed, the European Commission has connected the arm's length principle to EU State aid rules in its State aid decisions on Starbucks, Fiat, Apple, and Amazon.[22]

The European Commission's view on the relationship between the arm's length principle and State aid relies on the principle of equal treatment, which implies that standalone entities as compared to group entities should not be treated differently.[23] An important criticism on the European Commission's view is that there had previously not been reference to the arm's length principle in State aid case law. Instead, the CJEU had only confirmed that the prohibition of State aid follows the principle of equal treatment within the reference tax system.[24] In its State aid decisions, the European Commission thus went beyond reference to the ordinary tax system by concluding that the arm's length principle (i.e., the 'reliable approximation of a market-based outcome'), forms part of the prohibition of State aid, irrespective of whether or how a Member State has incorporated the arm's length principle in its domestic tax law.[25]

Despite this criticism, the GC initially confirmed that there is an arm's length principle inherent in the EU State aid rules that can be used as a 'tool' to verify whether profits of group entities are based on conditions that would have been negotiated between standalone enterprises.[26] As such, the arm's length principle would

[17] One particular reason why the arm's length principle might nonetheless prove to be relevant in a domestic context, is if the corporate tax system contains a progressive rate structure, in case of losses, or in case of economic double taxation of corporate profits. However, because many Member States allow some variant of a group regime, I suspect that few Member States have a legislative necessity to introduce an internal arm's length principle in a non-cross-border context.

[18] *See* the CJEU cases Test Claimants in the Thin Cap Group Litigation (C-524/04), Lankhorst-Hohorst, SGI (C-311/08), Hornbach-Baumarkt (C-382/16), and Lexel (C-484/19).

[19] For example CJEU, 20 Jan. 2021, C-484/19, *Lexel AB v. Skatteverket*, ECLI:EU:C:2021:34, paras 72–74. *See also* CJEU, 31 May 2018, C-382/16, *Hornbach-Baumarkt-AG v. Finanzamt Landau*, ECLI:EU:C:2018:366, paras 45–47 and CJEU, 21 Jan. 2010, C-311/08, *SGI*, ECLI:EU:C:2010:26, paras 60–64. In the opinion of A-G Kokott, 10 Sep. 2009, C-311/08, *SGI*, ECLI:EU:C:2009:545, paras 67–73, the commonly accepted arm's length principle in Art. 9 OECD MTC and Art. 4(1) of the EU Arbitration Convention is explicitly emphasized as a means to allocate taxing rights.

[20] I analysed the transfer pricing legislation of all Member States. Only Bulgaria, Cyprus and Estonia do not allow taxpayers to engage in transfer pricing rulings with tax authorities.

[21] European Commission, Commission Notice on the notion of State aid as referred to in Art. 107(1) of the Treaty on the Functioning of the European Union of 19 Jul. 2016, OJ C-262/1 (hereinafter: 2016 EC Notice), paras 170–171.

[22] Commission Decision (EU) 2017/502 of 21 Oct. 2015 on State aid SA.38374 (2014/C ex 2014/NN) implemented by the Netherlands to Starbucks, C(2015) 7143; Commission Decision (EU) 2016/2326, *supra* n. 3; Commission Decision (EU) 2017/1283 of 30 Aug. 2016 on State aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple, C(2017) 5605; and Commission Decision (EU) 2018/859 of 4 Oct. 2017 on State aid SA.38944 (2014/C) (ex 2014/NN) implemented by Luxembourg to Amazon, C(2017) 6740.

[23] 2016 EC Notice, *supra* n. 21, para. 171 and 2016 EC Working Paper, para. 4. The EC refers to CJEU, 22 Jun. 2006, C-182/03 and C-217/03, *Belgium and Forum 187 v. Commission*, ECLI:EU:C:2006:416. In the Forum 187 case, the CJEU required a comparison of the Belgian coordination centre regime with the ordinary tax system, based on the method of profit determination under conditions of free competition. The method of profit determination for coordination centres involved establishing taxable income as a fixed percentage of the full amount of operating costs and expenses, excluding employee and financial costs, which formed a selective advantage. *See* paras 91, 95–96, 112 and 118.

[24] The European Commission deemed that the EU arm's length principle derives from the CJEU Forum 187 case, *supra* n. 23. *See* C. Peters, *The Starbucks Decision of the General Court (Cases T-760/15 and T-636/16): Stepping Stone Towards a Sustainable Solution?*, in *CJEU – Recent Developments in Direct Taxation 2019* 4 (Lang et al. eds, Series on International Tax Law, Volume 119, Vienna: Linde Verlag 2019). *See also* F. Todhe, *The Rise of an (Autonomous) Arm's Length Principle in EU State Aid Rules*, 18(3) Eur. State Aid L.Q. 260 (2019).

[25] 2016 EC Notice, *supra* n. 22, para. 172. *See also* Commission Decision (EU) 2016/2326, *supra* n. 3, para. 228. However, as discussed later, the CJEU rejects this notion, *see* CJEU, 8 Nov. 2022, *supra* n. 1, para. 19.

[26] GC, 24 Sep. 2019, T-760/15 and T-636/16, *Kingdom of the Netherlands and Starbucks v. European Commission*, ECLI:EU:T:2019:669, paras 159–160; GC, *Grand Duchy of Luxembourg and*

give substance to the interpretation of an advantage within the meaning of the State aid prohibition.[27] In doing so, the GC limited the scope of the arm's length principle to the determination of the domestic tax base, so that the EU arm's length principle would not deal with the allocation of profit among Member States, thereby leaving the tax sovereignty of Member States – in principle – intact.[28]

Until now, the CJEU has only ruled in the State aid case concerning Fiat Finance, where the CJEU rejected the notion that there is an inherent arm's length principle in Article 107(1) TFEU.[29] Instead, the domestic reference framework determines the interpretation of the arm's length principle.[30] This ruling underlines Member States' tax sovereignty in direct taxation. If there is no arm's length principle in a Member State's domestic tax legislation, it is not part of the reference framework, and the OECD Transfer Pricing Guidelines remain external to the national tax system.[31]

3 An EU arm's length principle

3.1 Disparities in the Arm's Length Principle Between Member States

Before assessing whether the arm's length principle warrants harmonization at the EU level, it is important to assess the scope of Member States' disparities in the definition and application of the arm's length principle. At first sight, these disparities do not seem large, since all Member States have implemented an arm's length principle in their domestic transfer pricing legislation that is comparable to the definition in the OECD Transfer Pricing Guidelines.[32] However, the distinction between the *interpretation* of the definition of the arm's length principle itself and the *application* of the principle is important: Despite inclusion of the definition by all Member States, disparities in the application of the arm's length principle remain.

Some Member States only require arm's length adjustments in a cross-border context, implying that purely domestic transactions do not necessarily have to adhere to the arm's length principle.[33] Another issue is the fact that some Member States only require upward adjustments of taxable profit.[34] From the grammatical interpretation of the wording of the legislation in these Member States, downward adjustments of taxable income seem not strictly required.[35] In principle, this approach remains in line with the original objective of the arm's length principle of preventing tax abuse through transfer prices.[36] However, if one Member State makes an upward adjustment of taxable income in line with the arm's length principle, the lack of a downward adjustment by another Member State could result in economic double taxation.[37]

Nonetheless, most Member States do allow the downward adjustment of taxable profits in accordance with the arm's length principle. However, this in turn introduces a tax competition incentive. In order to attract business activities, Member States may be incentivized to agree with taxpayers on lower taxable profit through higher or lower transfer prices, resulting in reduced overall tax liability.[38] This renders transfer pricing a competitive tax instrument, implying that not only taxpayers may benefit from the open standard that is inherent in the arm's length principle.[39]

Regarding the application of specific transfer pricing methods, the OECD Transfer Pricing Guidelines provide a framework for approximating arm's length prices.[40] Despite the fact that these OECD Transfer Pricing

Fiat v. European Commission, *supra* n. 2, paras 111–113; GC, 15 Jul. 2020, T-778/16 and T-892/16, ECLI:EU:T:2020:338 (*Ireland and Apple v. European Commission*), para. 224.

27 Peters, *supra* n. 24, at 6.

28 *Ibid.*, at 8 and 16. *See also* P. J. Wattel, *Stateless Income, State Aid and the (Which?) Arm's Length Principle*, 44(11) Intertax 792 and 797 (2016).

29 CJEU, 8 Nov. 2022, *supra* n. 1, paras 72 and 96.

30 *Ibid.*, para. 96.

31 CJEU, 15 Nov. 2011, C-106/09 P and C-107/09 P, *Commission and Spain v. Government of Gibraltar and United Kingdom*, ECLI:EU:C:2011:732, para. 97. *See also* H. Vermeulen, *EU-Aarm's Length Principle' bestaat niet*, TaxLive Uitvergroot 2–3 (4 Jan. 2023).

32 EC, *Guidelines on Transfer Pricing – Frequently Asked Questions*, MEMO/14/394 of 4 Jun. 2014, at 1. Not all Member States have literally copied the OECD's definition, but the wording and substance of the arm's length principle that these Member States use in their domestic tax law seems in line with OECD TP Guidelines 2022, para. 1.6.

33 For example, Belgium's legislation uses the word 'multinational' in Art. 185 §2 Wetboek van de inkomstenbelastingen 1992, from which it could be inferred that the arm's length principle should only be applied in a cross-border context.

34 I compared tax legislation for all Member States. From the grammatical interpretation of the legislation, these Member States include Finland, France, Germany, Ireland, Italy, Malta, Slovak Republic, Slovenia and Sweden. As a practical example, Germany uses the word 'reduced' ('*gemindert*') in § 1 Außensteuergesetz, from which it could be inferred that the law only targets reductions of income.

35 However, from a teleological interpretation, it could be that these Member States do allow downward adjustments in case of non-arm's length pricing.

36 This is derived from the argument made in Wattel, *supra* n. 28, at 791.

37 Of course, such economic double taxation could be resolved by a bilateral double tax convention (in line with Art. 9 OECD MTC), or the EU Arbitration Convention. However, the threat of economic double taxation in the first place distorts economic decision-making and thereby threatens the economic efficiency of the EU internal market.

38 Higher transfer prices are beneficial in case of outgoing payments from a high-tax country, or in case of incoming payments in a low-tax country. Lower transfer prices are beneficial in case of incoming payments in a high-tax country or in case of outgoing payments in a low-tax country.

39 Wattel, *supra* n. 28, at 791.

40 OECD TP Guidelines 2022, Ch. 1. For a historical overview of the arm's length principle, *see* Petruzzi, *supra* n. 10, at 1–32.

Guidelines are non-binding, they are an authoritative source of guidance. Some Member States have even formally adopted the Guidelines in their transfer pricing regulation.[41] However, not all Member States follow the OECD Transfer Pricing Guidelines or adhere to the methods provided, and there remain substantial disparities in the detailed application of transfer pricing methods between Member States.[42]

3.2 Member States' Tax Sovereignty

Potential harmonization of the arm's length principle requires weighting the relationship between Member States' tax sovereignty in the realm of direct taxation against the goal of safeguarding the EU internal market by addressing harmful tax competition.[43] The EU fundamental freedoms do not affect the sovereignty of Member States with respect to the allocation of taxing rights among them. This means that, in principle, disparities between different Member States regarding tax base determination cannot constitute discrimination in light of the fundamental freedoms.[44] Hence, tax sovereignty implies that Member States do not have to be concerned with the determination of the tax base of foreign affiliates by other Member States.

4 What Problems Would Harmonization Address?

4.1 Double Non-taxation

The arm's length principle is fundamental to anti-abuse and anti-tax competition objectives.[45] Aggressive tax planning through transfer (mis)pricing can be a fundamental threat to free EU internal market competition, as the opportunity to artificially lower their overall tax liability would give multinational enterprises an advantage over standalone enterprises. The harmonization of an EU arm's length principle should therefore principally aim to protect the internal market by creating a level playing field for multinational enterprises and standalone enterprises.

In particular, harmonization of an EU arm's length principle would address a two-fold problem that derives from the general objectives of the arm's length principle. The first objective is the 'fair' determination of the tax base with the objective of preventing tax abuse and the second objective is the balanced allocation of taxing rights among Member States in a way that is in line with economic rationality. Transfer prices allocate taxable income among jurisdiction, so that in principle, transfer prices in one Member State should correspond to transfer prices in another Member State, and double non-taxation should not occur.

However, currently, double non-taxation may persist as a result of a differential application of the arm's length principle. This implies that without harmonization, Member States remain able to engage in tax competition through absence of adequate transfer pricing regulation or lax enforcement of the principle.[46] Indeed, tax sovereignty means that without a democratic legislative basis, no taxes can be levied and only national provisions are relevant for whether the arm's length principle plays a role in assessing transfer prices.[47] Therefore, if no arm's length principle is included in domestic tax law, EU State aid rules cannot act as replacement and target double non-taxation.[48]

4.2 Interpretation and Application

Again, a distinction should be made between the *interpretation* of the arm's length principle itself, and the *application* of the principle in practice. Interpretation of the principle assesses whether the principle is correctly applied, but does not prescribe the method of application.[49] Therefore, codifying the definition of the arm's length principle does not solve the problem of the arm's length principle being an open standard in its *application*.

However, codification does allow harmonization of the *interpretation* of the principle. One important argument in favour of harmonization is that if the arm's length principle becomes part of secondary EU law, the

[41] Commission Decision (EU) 2016/2326, *supra* n. 3, para 84–87.

[42] The OECD Transfer Pricing Country Profiles show that Finland, France, and Sweden declare that they do not adhere to the methods provided in the OECD Transfer Pricing Guidelines. *See also* Commission Staff Working Paper, Company Taxation in the Internal Market Com(2001)582 final, Preface, para. 45 that raises concern on these disparities.

[43] P. J. Wattel, *Forum: Interaction of State Aid, Free Movement, Policy Competition and Abuse Control in Direct Tax Matters*, 5(1) World Tax J. 128–144 (2013).

[44] CJEU, 12 Jul. 2005, C-403/03, *Schempp*, ECLI:EU:C:2005:446, para. 43. Regarding the arm's length principle specifically, *see* the opinion of A-G Geelhoed, 29 Jun. 2006, C-524/04, *Test Claimants in the Thin Cap Group Litigation*, ECLI:EU:C:2006:436, para. 40 and the there-cited opinions.

[45] M. F. Nouwen, *Inside the EU Code of Conduct Group: 20 Years of Tackling Harmful Tax Competition* 383–398 (Amsterdam: IBFD 2021) shows the tension between harmful tax competition, the arm's length principle and State aid.

[46] Transfer pricing regulation leads to a decrease in investment, *see* R. De Mooij & L. Liu, *At a Cost: The Real Effects of Transfer Pricing Regulations*, 68(1) IMF Econ. Rev. 268–306 (2020). Thus, countries have an incentive to not enforce transfer pricing regulation if the expected benefit from increased investment outweighs the potential cost of lax transfer pricing rules.

[47] R. H. C. Luja, *Do State Aid Rules Still Allow European Union Member States to Claim Fiscal Sovereignty?*, 25(5–6) EC Tax Rev. 323 (2016).

[48] An interesting point is whether the applicable double tax convention contains the standard version of Art. 9 OECD MTC, which could be viewed as making the OECD Commentary and thereby reference to the OECD Transfer Pricing Guidelines part of the national tax system as the reference framework. However, analysis of this issue is beyond the scope of this article.

[49] This distinction is important, because as noted, application the methods remain subject to reflexivity.

CJEU would become the competent judiciary to interpret its substance. Practically, this could be achieved by inclusion of the arm's length principle in the existing Anti-Tax Avoidance Directive, by requiring that related parties should value intra-group transactions for tax purposes based on the value that would be derived if these transactions were carried out under market conditions.[50] This would safeguard the monitoring of the required reflexivity on behalf of both taxpayers and tax administrations. Furthermore, by codifying a non-discriminatory arm's length principle, Member States will have to apply the principle in domestic situations and in both upward and downward adjustments of taxable profit, solving potential discrimination regarding the fundamental freedoms.

While the application of the arm's length principle by Member States could still differ, harmonization would make the assessment of whether a transfer pricing ruling confers State aid based on a selective application of the arm's length principle the task of the CJEU. It is uncertain whether transfer pricing rulings always comply with the principle of legality, because they are not subject to approval by the legislature. Harmonization does not solve the legality question with respect to transfer pricing rulings themselves, but it does solve the legality question with respect to the interpretation of the arm's length principle. This would level the playing field between the Member States and leaves the burden of proof for the existence of a selective advantage with the European Commission.

Therefore, fears that an EU arm's length principle would result in the European Commission de facto determining which Member State can tax certain profits are unwarranted. Instead, the harmonization of an EU arm's length principle would ensure the common interpretation of the arm's length principle, so that in principle, double non-taxation should no longer occur. This implies that not the European Commission, but market conditions would determine the allocation of taxable profits among Member States, precisely as the arm's length principle intends.

4.3 Comparability and Equal Treatment

Analysing the arm's length principle in light of both the EU fundamental freedoms and State aid requires comparability.[51] Without harmonization of the arm's length principle, Member States' sovereignty in direct taxation implies that there cannot be a common interpretation of the principle. This implies that the CJEU's interpretation of the application of the arm's length principle would remain bound by Member States' domestic tax legislation.[52] In that case, whether there is an unjustifiable restriction of fundamental freedoms or granting of State aid would remain dependent on the objectives of domestic tax law.

Substantiating the principle of equal treatment requires defining the subject of comparison.[53] In principle, the subject of comparison should be found with reference to domestic tax law.[54] In the context of the fundamental freedoms, comparability asks whether a cross-border arrangement is factually and legally comparable to a purely domestic arrangement. In the context of State aid, comparability asks whether independent and associated entities are factually and legally in a comparable situation. In both cases, the principle of equal treatment is imperative.[55]

In absence of harmonization, finding the subject of comparison would take place through a case-by-case approach, which requires the analysis of the objectives of a Member State's national tax legislation before establishing the existence of a restriction of the fundamental freedoms or the existence of a selective tax advantage that constitutes illegal State aid. Incorporating an arm's length principle in secondary EU law would ensure that independent and affiliated enterprises are in a comparable position, which leaves only the facts to be compared.

4.4 Subsidiarity and Proportionality

Harmonization should be limited to objectives that Member States cannot achieve on their own, provided that the EU can do better.[56] In theory, a harmonized arm's length principle could benefit the internal market by restoring and maintaining a level playing field between standalone enterprises and multinational enterprises. Member States would be obliged to refrain from using transfer pricing as a tax competition instrument based on different domestic interpretations of the arm's length principle.[57] Furthermore, international disparities that allow for profit shifting through transfer pricing should be reduced.[58]

[50] *See* OECD TP Guidelines 2022, para. 1.6 for the OECD's definition of the arm's length principle, which could be included in Council Directive (EU) 2016/1164 of 12 Jul. 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, O-J L 193/1.

[51] The CJEU considers that the comparability test should be dependent on the domestic reference system, *see* CJEU, 8 Nov. 2022, *supra* n. 1, paras 94–95.

[52] de la Feria, *supra* n. 9, at 5.

[53] GC, *Kingdom of the Netherlands and Starbucks v. European Commission*, *supra* n. 26, para. 157. *See also* Peters, *supra* n. 24, at 9.

[54] The CJEU considers that the comparability test should be dependent on the domestic reference system, *see* CJEU, 8 Nov. 2022, *supra* n. 1, paras 18 and 93.

[55] This can also be derived from Todhe, *supra* n. 24, at 261.

[56] To test subsidiarity and proportionality, the EU's task force on Subsidiarity, Proportionality and 'Doing Less More Efficiently' has created an assessment grid for evaluating the subsidiarity and proportionality of EU-level action. *See* EC, *Report on the Task Force on Subsidiarity, Proportionality and 'Doing Less More Efficiently'* 10 and 32–33 (10 Jul. 2018) (hereinafter: 2018 EC Report on Subsidiarity and Proportionality).

[57] This is derived from the argument made in Wattel, *supra* n. 28, at 791.

[58] Dourado, *supra* n. 7, at 4.

However, the nature of the arm's length principle might render the benefits of harmonization for the internal market less effective than intended.[59] Using the arm's length principle in judging whether a tax advantage constitutes State aid or whether transfer prices are abusive remains difficult because the arm's length principle itself does not lead to a straightforward and objective determination of the existence of a tax advantage.[60] Fundamentally, it remains a matter of interpretation whether the arm's length principle is incorrectly applied.[61] Therefore, even though there are good arguments to harmonize the arm's length principle, whether harmonization would satisfy the subsidiarity and proportionality requirements deserves another careful evaluation.

5 Should the arm's length principle be harmonized?

5.1 Would Harmonization Benefit the Internal Market?

The legal basis for harmonization of an arm's length principle lies in the general provisions that aim to ensure the functioning of the EU internal market.[62] Evaluating whether an EU arm's length principle improves the functioning of the internal market from an economic standpoint introduces a fundamental insight into the role of the arm's length principle as a legal fiction. Economic theory implies that group entities would never transact with each other under competitive conditions, because by definition, such conditions do not apply to relationships between affiliated entities.[63]

In a multinational enterprise, there are no market prices due to economies of scale, economies of synergy, etc.[64] Indeed, multinational enterprises are successful, because they are able to integrate operations for more efficient production than the market can achieve on its own. Hence, the allocation of resources within a multinational enterprise does not necessarily follow the allocation of resources in external markets.[65] Therefore, a fundamental criticism on the arm's length principle is that transfer prices are not in line with economic theory and that they are only relevant for tax purposes.

From this economic standpoint, commercial rationality within a multinational enterprise should not be inherent in the arm's length principle.[66] Indeed, transfer pricing might distort the incentives for optimizing production processes, so that the arm's length principle could actually impede the functioning of the internal market.[67] This is because – as a legal fiction – the arm's length principle takes away the tax incentives for becoming a multinational group, but also distorts economic incentives. Therefore, the arm's length principle is not unambiguously beneficial for the freedom to efficiently allocate resources within the EU internal market.[68]

5.2 Can the Open Standard Be Closed?

Having emphasized that the arm's length principle is a legal construct, another significant drawback of the arm's length principle is that it remains an open standard. Fundamentally, the arm's length principle cannot account for residual profits that result from multinationals' above-market returns.[69] Such above-market returns may be the result from economic synergies or unique firm-specific value from risks, intangibles or capital.[70] Therefore, as an approximation, the arm's length principle aims to allocate residual profits through the economic rationality of competitive markets.[71]

[59] It should be recalled here that all EU Member States have implemented an arm's length principle that, in terms of definition, follows the OECD's arm's length principle.

[60] J. Monsenego, *Selectivity in State Aid Law and the Methods for the Allocation of the Corporate Tax Base* 136–144 (EUCOTAX Series on European Taxation, Vol. 60, Alphen aan den Rijn: Kluwer Law International 2018).

[61] Compare R. Bonnici, *The European Commission's Arm's Length Standard: Relationship and Compatibility With the Arm's Length Principle Under Transfer Pricing*, 26(1) Int'l Transfer Pricing J. 58 (2019). The author goes further and criticizes the European Commission for using the word 'unlikely', as this implies that the European Commission will not necessarily let itself by bound by the OECD TP Guidelines, which increases legal uncertainty.

[62] Article 114(2) and 115 TFEU. *See* R. Szudoczky & D. Weber, *Constitutional Foundations: EU Tax Competences; Legal Basis for Tax Integration; Sources and Enactment of EU Tax Law*, in *European Tax Law, Volume 1: General Topics and Direct Taxation* 20–21 (P. J. Wattel, O. Marres & H. Vermeulen eds, 7th ed., Alphen aan den Rijn: Kluwer Law International 2018).

[63] This is confirmed in the US-GAAP rules, *see* SFAS No.57, para. 3. *See also* OECD TP Guidelines 2022, paras 1.10–1.11.

[64] Luja, *supra* n. 47, at 323.

[65] Additionally, the issue with paras 171–172 of the 2016 EC Notice is that the CJEU did not include the notion that free competition should be defined as 'independent undertakings negotiating under comparable circumstances at arm's length', as this was added by the EC. *See* Luja, *supra* n. 47, at 323.

[66] For this reason, there is criticism on the CJEU's notion that taxpayers that engage in transactions that are motivated by commercial rationality should not be targeted by anti-abuse rules. *See* Schön, *supra* n. 10, at 94. *See also* Petruzzi, *supra* n. 10, at 27–28.

[67] *See* e.g., J. Hirshleifer, *On the Economics of Transfer Pricing*, 29(3) J. Bus. 172–184 (1956); A. H. Amershi & P. Cheng, *Intrafirm Resource Allocation: The Economics of Transfer Pricing and Cost Allocations in Accounting*, 7(1) Contemp. Acct. Res. 61–99 (1990). *See also* S. J. Grossman & O. D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94(4) J. Pol. Econ. 91–719 (1986); and B. Holmstrom and J. Tirole, *Transfer Pricing and Organizational Form*, 7 J.L. Econ. & Org. 201–208 (1991).

[68] OECD TP Guidelines 2022, para. 1.8.

[69] R. S. Avi-Yonah, *The Rise and Fall of Arm's Length: A Study in the Evolution of US International Taxation*, 15(1) Va. Tax Rev. 148–149 (1995–1996). To some extent, the benefits from being a multinational group are recognized in the OECD TP Guidelines, e.g., when it comes to corporate synergies, *see* Bonnici, *supra* n. 61, at 60, who refers to the OECD TP Guidelines 2017, paras 1.6, 7.13, 1.159–1.160 and 1.122.

[70] M. Kane, *Transfer Pricing, Integration and Synergy Intangibles: A Consensus Approach to the Arm's Length Standard*, 6(3) World Tax J. 282–314 (2014).

[71] M. F. de Wilde, *Sharing the Pie: Taxing Multinationals in a Global Market* 342–344 (Rotterdam: dissertation Erasmus University 2015).

Again, the market comparison implies that the arm's length principle does remove tax advantages from economic integration. Indeed, the OECD Transfer Pricing Guidelines include in the definition of the arm's length principle the 'parity of tax treatment' and the 'creation of an equal footing' between independent and affiliated enterprises, which commits to the principle of equality.[72] However, not all transfer prices that are considered to be at arm's length are necessarily non-discriminatory, due to the inherent arbitrariness in the process of determining transfer prices.[73]

The OECD Transfer Pricing Guidelines primarily provide a procedure that introduces formulaic and approximate approaches to determine an arm's length residual profit allocation based on market comparisons.[74] This market comparison renders the arm's length principle inherently arbitrary, because the comparability methods may not always be able to accurately reflect the economic reality of the transaction or the market conditions under which the transaction occurs. In principle, taxpayers are free to choose a transfer pricing method, as long as that method results in a transfer price that adheres to the arm's length principle.[75]

It is theoretically and practically difficult to find appropriate comparables for those transactions that derive from competitive group advantages.[76] Applying the same arm's length principle in the same situation by different parties is therefore likely to result in a different allocation of profits.[77] The question is how to accurately delineate the transaction, interpret the functional analysis and determine the correct comparables. Even if there is agreement on which comparables are appropriate, applying a transfer pricing method will often result in a range of acceptable arm's length prices.[78]

This fundamental issue cannot be resolved through harmonization of the arm's length principle and the OECD Transfer Pricing Guidelines, because it is the nature of an open legal standard that requires taxpayer reflexivity.[79] Therefore, even though harmonization would resolve the question of comparability, it does not necessarily result in equal outcomes. Hence, agreeing on a common definition of the arm's length principle would not provide the ultimate solution to transfer pricing mismatches.

5.3 Would There Be Scope for Unanimity?

Until now, the closest step to harmonization was reached through the conclusion of the EU Arbitration Convention in 1990.[80] The EU Arbitration Convention explicitly refers to the arm's length principle by requiring that profits derived from transactions between related entities that are concluded under conditions that differ from conditions that would prevail between independent entities, may be adjusted to reflect such independent conditions and may be taxed accordingly.[81] With the conclusion of the Convention, it was suggested that decisions by arbitration commissions would lead to the harmonization of the arm's length principle.[82] However, with around nine hundred arbitration cases being presented each year, the application of the arm's length principle by Member States still seems to generate interpretative issues.[83]

Harmonization would require that all Member States are willing to harmonize the arm's length principle, because EU Directives adopted in the area of direct taxation require unanimity.[84] There are no current surveys of the views and preferred courses of action of Member States, but the EU Joint Transfer Pricing Forum (hereinafter: JTPF) provides indications of Member States' views. Since 2002, the JTPF has been a cooperation between Member States and non-governmental organizations to coordinate on guidance or recommendations regarding transfer pricing within the EU.[85] This cooperation implies a willingness of Member States to coordinate their domestic transfer pricing framework. However, the JTPF only provides non-binding recommendations and has not published guidance since 2019. This suggests that also on a unanimity level, harmonizing the arm's length principle might prove unfeasible.

[72] OECD TP Guidelines 2022, para. 1.8.
[73] Bonnici, *supra* n. 61, at 60.
[74] This procedural framework relies on aspects such as the functional analysis, the choice of the tested party, and the choice of the most appropriate transfer pricing method. *See* Peters, *supra* n. 14, at 33.
[75] OECD TP Guidelines 2022, para. 2.9.
[76] Peters, *supra* n. 14, at 32.
[77] W. Haslehner, *Double Taxation Relief, Transfer Pricing Adjustments and State Aid Law*, in *State Aid Law and Business Taxation* 144–146 (I. Richelle, W. Schön & E. Traversa, Berlin: Springer 2016).
[78] OECD TP Guidelines 2022, s. A.7. *See also* Todhe, *supra* n. 24, at 261–262. This is recognized by the European Commission by noting that the point closest to the true arm's length price should be chosen within a range, *see* Commission Decision (EU) 2017/502, *supra* n. 22, para. 396.
[79] Bonnici, *supra* n. 61, at 60.
[80] Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC).
[81] Article 4(1) in connection with Art. 12(1) of the Arbitration Convention. However, as noted in Pistone, *The Settlement of Cross-Border Tax Disputes in the European Union*, in *European Tax Law, Volume 1: General Topics and Direct Taxation* 178 (P. J. Wattel, O. Marres & H. Vermeulen eds, 7th ed., Alphen aan den Rijn: Kluwer Law International 2018), the Arbitration Convention does not specify to which arm's length method it adheres.
[82] L. Hinnekens, *Different Interpretations of the European Tax Arbitration Convention*, 7(4) EC Tax Rev. 251 (1998).
[83] European Commission, Taxation and Customs Union, *Overview of Numbers Submitted for Statistics on Pending Mutual Agreement Procedures (MAPs) Under the Arbitration Convention (AC) at the End of 2019 and 2020*, Ref. Ares(2021)1802078 – 12 Mar. 2021 and Ref. Ares(2022)949416 – 09 Feb. 2022.
[84] Article 115 TFEU. I will not cover the possibility of enhanced cooperation in Art. 326–334 TFEU. *See also* Englisch, *supra* n. 5, on Art. 116 TFEU.
[85] For a background on the JTPF's background and functioning, *see* H. M. Pit, *Improving the Arbitration Procedure Under the EU Arbitration Convention (1)*, 24(1) EC Tax Rev. 15–17 (2015).

5.4 No Harmonization After All?

Fundamentally, the arm's length principle retains its approximate nature.[86] Because of the formulaic approach in transfer pricing methods, harmonizing the arm's length principle cannot fully eliminate tax abuse. At the tax planning level (i.e., the group's structuring), taxpayers may remain encouraged to design transactions in a way to fit the parameters of a certain transfer method to achieve a reduction in tax liability.[87] At the outcome level (i.e., the transfer price), the approximation issue is inherent in the transfer pricing methods itself, as they estimate a 'counterfactual' price that would have been charged between independent parties through comparable transactions and formulaic approaches.

As such, the arm's length principle itself is not necessarily appropriate to deal with tax competition and aggressive tax planning, particularly because all Member States have already implemented an arm's length principle in their national tax legislation. Instead of launching another anti-tax avoidance project and aiming to harmonize the arm's length principle, the EU institutions might want to save their resources for adequately furthering current initiatives in the field of international business taxation.[88]

Other anti-tax competition initiatives such as the global minimum tax in the Pillar Two Directive[89] will also diminish the incentives for Member States to engage in harmful tax competition. This Directive ensures that large multinational enterprises would be subject to a minimum level of taxation, reducing the incentive for Member States to attract business through lower effective tax rates.[90] Admittedly, the Pillar Two Directive leaves smaller taxpayers out of scope, but due to State aid risks, most Member States will still be discouraged to provide selective tax incentives to smaller multinational enterprises. Furthermore, at the taxpayer level, the obligation under the mandatory disclosure rules (Sixth Directive on Administrative Cooperation[91]) to report certain tax planning arrangements already ensures an improved monitoring of aggressive transfer pricing behaviour.[92]

Moving forward, for taxpayers that are confronted with transfer pricing adjustments, the EU Arbitration Convention still provides an ex-post instrument to relieve economic double taxation through requiring that when transfer prices are determined in line with the arm's length principle, economic double taxation should be relieved.[93] Thus, even though the EU Arbitration Convention does not provide the *a priori* prevention of economic double taxation resulting from a differential interpretation of the arm's length principle, it at least should provide *ex-post* relief, be it that the Convention has its own shortcomings.[94]

6 Conclusion

The arm's length principle forms the international cornerstone of transfer pricing and is of vital importance for maintaining a tax-level playing field between multinational groups of taxpayers and standalone enterprises. Despite the fact that all Member States implemented an arm's length principle in their domestic transfer pricing legislation, substantial disparities in the application of the principle remain.

Disparities in the application of the arm's length principle by Member States create two challenges for the internal market. The first issue is that of a potentially unjustified restriction of the fundamental freedoms when Member States only apply the arm's length principle in a cross-border context, which impedes the free and competitive allocation of resources within the EU internal market by favouring domestic transactions. The second issue is that the arm's length principle can be used as a tax competition instrument if Member States engage in beneficial transfer pricing rulings with taxpayers, thereby granting a State aid benefit in the form of reduced tax liability. The need to protect the internal market seems to warrant EU-level harmonization of the arm's length principle.

However, any potential harmonization effort requires weighting Member States' tax sovereignty in the realm of direct taxation. In this regard, there are good theoretical arguments that harmonization of the arm's length principle would solve important issues. However, the fundamental problem of the arm's length principle is that it constitutes an open legal standard that requires reflexivity from taxpayers and proper monitoring by tax administrations. Therefore, the arm's length principle remains an

[86] Monsenego, *supra* n. 60, at 3.

[87] For economic theory showing that transfer pricing methods affect profit shifting behaviour, *see* S. B. Nielsen, D. Schindler & G. Schjelderup, *Abusive Transfer Pricing and Economic Activity*, CESifo Working Paper Series No. 4975, 1–22 (2014). *See also* S. Juranek, D. Schindler & G. Schjelderup, *Transfer Pricing Regulation and Taxation of Royalty Payments*, 20(1) J. Pub. Econ. Theory 67–84 (2018).

[88] Such as Unshell, BEFIT, DEBRA, the Pillar One and Pillar Two Directives, etc.

[89] Council Directive (EU) 2022/2523 of 14 Dec. 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, *O-J* L 328/1.

[90] M. F. de Wilde & C. Wisman, *Chapter 1: OECD Consultations on the Digital Economy: 'Tax Base Reallocation' and 'I'll Tax If You Don't'?*, in *Taxing the Digital Economy: The EU Proposals and Other Insights* 14–19 (P. Pistone & D. Weber eds, Amsterdam: IBFD 2019).

[91] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, *O-J* L 139/1.

[92] Especially the hallmarks under Category E in Annex IV to Council Directive 2011/16/EU of 15 Feb. 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC.

[93] *See also* Pit, *supra* n. 85, at 26.

[94] *See* the work of H. M. Pit, *Dispute Resolution in the EU – The EU Arbitration Convention and the Dispute Resolution Directive* (IBFD Doctoral Series, nr. 42, Amsterdam: IBFD 2018).

imperfect international standard in transfer pricing, which can only be improved through diligent application of the reflexivity that is inherent in transfer pricing by both tax administrations and taxpayers.

Because of the imperfect open standard of the arm's length principle in addressing tax competition by Member States and aggressive tax planning by taxpayers, harmonizing the application of the arm's length principle at the EU level seems impossible. Particularly, harmonizing the definition of the arm's length principle does not necessarily resolve transfer pricing mismatches, because of the inherent arbitrariness in the application of transfer pricing methods. Refraining from trying to harmonize the application of the arm's length principle avoids unanimity issues and might thereby even improve Member States' willingness to cooperate on resolving double (non-)taxation issues. Therefore, in order to safeguard the integrity of the EU internal market, other initiatives to curb tax competition and aggressive tax planning should receive priority instead.