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EU JOINT TRANSFER PRICING FORUM

QUESTIONNAIRE ON THIN CAPITALIZATION

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Thin capitalization and the Arbitration Convention

In order to assess the current position in the EU, MS have agreed to say whether or not they consider a case of "thin capitalization" to be solvable under the Arbitration Convention. The JTPF considers that this analysis will be useful to both taxpayers and tax administrations.

Different tax administrations have different rules used to look at debt arrangements between associated persons. In some countries, "normal" transfer pricing rules apply. In some countries, there are special rules. Some countries have both. But all rules tend to consider the problem in a similar fashion: the outcome must be that the debt arrangements reflect those which would have existed between third parties.

By "thin capitalization" tax administrations typically mean looking at the rate of interest charged between associated persons or the amount of the debt on which interest is charged. When considering the amount of the debt, tax administrations look at the amount which could have existed at arm's length (borrowing capacity) and also some tax administrations look at the amount of debt which would have existed (borrowing capacity and attitude to debt and/or risk.).

With this in mind, the JTPF asks you to say whether or not you would accept a case into the AC where your tax administration:

- reduces the rate of interest paid on an inter-company loan
- reduces the amount of a loan on which interest is paid because of the limited borrowing capacity of the debtor
- reduces the amount of a loan on which interest is paid because the debt would not have existed for reasons unrelated to borrowing capacity.
- reduces the amount of a loan on which interest is paid because the debt exceeds a thin cap ratio

Please say the reasons if your answer is negative.

Finally, please say whether your view would differ if the actions above had been taken by another tax administration and you were being asked to give a corresponding adjustment.