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EU JOINT TRANSFER PRICING FORUM

CONSOLIDATED DOCUMENT ON SUGGESTIONS RECEIVED FOR THE JTPF 2007-2008 WORK PROGRAMME

Meeting of 28th June 2007

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This document presents all comments received on the future work programme of the JTPF for 2007-2008. It includes information from Doc. JTPF/007/BACK/2006/EN, Doc. JTPF/021/BACK/2006/EN, Doc. JTPF/030/REV2/BACK/2006/EN and more recent information included in a document drafted by MS subgroup in Barcelona (Doc. JTPF/008/BACK/2007/EN and a new document sent by Business Europe (former UNICE) on 06th June.

1. Business Europe contribution (June 2007)

Proposed target areas of the EUJTPF

The BusinessEurope Task Force on the EU Joint Transfer Pricing Forum (EUJTPF) is grateful for this opportunity to express its views on the upcoming agenda of the EUJTPF. The Task Force considers the topics presented in the document as being of particular importance for the Forum's upcoming work. The issues are listed in order of importance.

1. **Monitoring of the implementation and application of the Arbitration Convention (AC) and TPD Codes of Conduct as well as the APA Code of Best Practices.**

   Issue: Taking into consideration that the three Codes invite Member States to report to the Commission on their implementation and the practical problems faced with their implementation, this topic is of course of major importance and must be considered as a continuous task of the EUJTPF. Furthermore, the Forum has an important role to play in monitoring how the suggestions and best practices developed by the Forum are being implemented across the EU.

   Preferred solution/approach: Business has an important role to play, by reporting the problems encountered which are not in line with the Code of Conducts. This could be done by channelling real life experiences through the various networks among consultants, business federations etc. BusinessEurope has a crucial role to play in this respect.

2. **HQ or Central Services and the evidence that they are justified and chargeable out to the affiliates.**

   Issue: Many centralized services are for the benefit of a group and it is not always made clear to the group companies and their tax administrations what the rationale is for their existence and their charge-out.

   Preferred solution/approach: As a rule, it should be recognized by the Member States that a business only has business expenses, which should be deductible at least somewhere. If such expenses relate to centralized services which are susceptible to be used by a local entity, such expenses must be allowed to be split among the potential users, based on a reasonable and verifiable key.

3. Arbitration Convention (AC) and Mutual Agreement Procedures (MAP)

On the area of the AC and MAPs, the Task Force would like to emphasize three important areas of improvement:

a) *Issue:* Tax collection and treatment of interest payments in AC/MAP cases. Under the AC, there are two related issues that remain still open; rules on suspension of the collection of tax under the Arbitration Convention and the treatment of interest payments.

Preferred solution/approach: All tax collection must be suspended in AC/MAP-cases. As for interest payments, the tax administrations should coordinate the interest payments and the reimbursements.

b) *Issue:* Transfer Pricing adjustments through AC/MAP and penalties. Occasionally, a penalty situation can arise when a transfer pricing adjustment is made between related taxpayers based on an agreement between the tax administrations within the context of a MAP/AC procedure, despite the fact that that the taxpayer's original pricing was within an acceptable range of possible arm's length prices.

Preferred solution/approach: In cases where the taxpayer's original pricing can be regarded as being within an acceptable range arm's length prices, albeit later adjusted based on a MAP/AC, there must be no penalty at all on either taxpayer.

c) *Issue:* MAP/AC procedure and interaction with administrative and judicial appeals. The interaction of the mutual agreement and arbitration procedure with administrative and judicial appeals (article 7(1) and (3) of the AC) remains from the previous Forum. On this issue, there is a direct link to the OECD's work on dispute resolution which states domestic remedies may be suspended.

Preferred solution/approach: The Forum could consider what the best European approach is on this issue.

4. Preparation of impact analyses with respect to the current problems referring Transfer Pricing issues and the work done and announced by the EUJTPF

Here we would like to highlight two related issues:

Issue I: Transfer pricing constitutes a cost to society. We distinguish two angles:

a) in-ability or reduced ability to do business according to commercial best practice. This causes sub-optimal business structures.

b) the requirement to calculate prices of goods or services when they cross a border within an Internal Market. This is unnecessary, time consuming and costly.

The question is raised to learn what the impact is in the EU of maintaining within the EU a corporate tax system that forces the continued recognition of transfer pricing when a product

or a service crosses a border. The information determines the need and speed by which to change the transfer pricing environment to reduce impact on EU welfare and GDP growth.

Preferred solution/approach: To engage third parties such as Universities and other research institutions to prepare a macro-economic impact analysis with respect to the current problems referring to Transfer Pricing issues.

Issue II: What has been the objectively measured success of the EUJTPF so far? Determine to what extent administrative costs have been reduced for taxpayers; to what extent has double taxation been reduced?

Preferred solution/approach: Prepare an impact analysis of the work done by the EUJTPF so far. Use the business test panel to poll.

5. Alternative ways of dispute resolution (e.g. prior consultation among administrations)

Issue: One Member State has already suggested a form of prior consultation – a "high level functional analysis". Such and approach could very well form the basis of a discussion aimed at developing this approach within the EU.

Preferred solution/approach: The Forum could look at the incidence of the application of Transfer Pricing rules across the EU and perhaps develop some guidance about when a transfer pricing related audit is likely to be a meaningful and cost effective endeavour for tax administrations.

A cost effective way would be to allow the tax inspector raising the issue to contact his counterpart in the other country with a view to see whether an issue can be resolved quickly. This requires an enabling and efficient legal framework.

6. Thin Capitalization Regulations and the Arbitration Convention

Issues: Thin capitalization was excluded from the AC Code discussion as not being within the realm of transfer pricing (notwithstanding the fact that Article 4 of the AC refers to the “commercial or financial relations” between two enterprises). Nevertheless, the UK brought thin capitalization into the transfer pricing arena. Furthermore, one cannot exclude thin capitalization from transfer pricing when interest on inter-company loans are covered by TP-rules. Accordingly, it should be within the scope of the AC to require a Member State that intends to make a thin capitalization adjustment to ensure that a corresponding adjustment will be made in the other Member State.

Furthermore, we are concerned about the risk of a gradual shift from debt equity ratios (which are relatively easy to monitor) to interest coverage rules (where a company fully depends on the economic situation). If country A applies thin capitalization rules and re-characterises interest into dividends (by applying the TP-rules on interest rates) and withholds tax on dividends, there is no way to get a relief in country B. In such a case, taxpayer A would have to go into a MAP under article 10 and taxpayer B under article 11. If Member State A and B agree to disagree, taxpayers A and B cannot ask for the application of the Arbitration Convention (AC) if one of the two countries argues that thin capitalization does not fall under

the TP-rules.

Preferred solution/approach: It should be considered whether thin capitalization rules should be treated as being within the scope of the AC Code, covering "commercial or financial relations" between two enterprises. In addition, it should be clarified if the arm's length test also applies to thin capitalization rules. This does not only apply to thin capitalization, but also to earnings strippings/interest coverage rules.

7. **Agreement on standards regarding the arm's length test (including questionable legitimacy of retroactive adjustments to inter-company purchase prices – based on *actual* profits – and their consequences for the other contracting state)**

Issue: We would like to emphasize two issues in this respect:

a) The issue of secret comparables.

b) The issue of retroactive adjustments to transfer prices based on *actual* results (as opposed to projections at the time of the respective transfer). In at least one Member State, the tax authorities will soon have the right to make retroactive adjustments of transfer prices within a period of 10 years in cases where the actual income derived from a particular asset supports a higher fair market value than anticipated by the counterparties at the time of the transfer. In this case, the tax authorities may re-assess the tax burden. Unless the other contracting state is equally willing to make a retroactive reassessment (for instance, higher depreciation on IP over the last 10 years), the taxpayer will be subject to double taxation. At issue is:

(i) whether or not the tax authorities should be allowed at all to overrule best-practice fair market value estimations at the time of a transfer based on information that is available only in the future (i.e., actual profits derived within a 10 year period following the transfer), and, if so,
(ii) whether or not the Member State that intends to make the retroactive adjustment should be obligated to ensure that a corresponding adjustments is made by the other Member State (in order to avoid double taxation).

Preferred solution/approach: Retroactive adjustments to taxable income based on actual results (as opposed to best practice estimates at the time of the transfer) clearly violate the arm's length standard. Accordingly, such adjustments should not be admissible under any circumstances. It should therefore be made clear that retroactive corrections are not allowed. There must not be a "commensurate with income"-standard that is applied with the benefit of hindsight.

8. **Business restructurings**

Issue: In some countries (most notably Germany) there are some far-reaching transfer pricing guidelines possibly being issued which go beyond the OECD guidelines. More specifically, this refer to TP-rules regarding the relocation of functions and business restructurings. With respect to the German proposal, it intends to have a compensation system installed each time a function is relocated cross-border to another country. This does most likely go against the

EU-treaty and must be prevented.

9. Transfer Pricing requirements with respect to SMEs

Issue: As a matter of principle, all businesses should be treated the same for transfer pricing purposes regardless of their sizes. It could be reviewed, however, to what extent current documentation requirements could be relieved in cases where they put a disproportionate burden on the business relative to its capacity. Such a relief should, however, not refer only to separate entities of a certain size, but also to parts of larger businesses that can be recognised as a separate business activity. This is important not to discriminate small operations/businesses that are embedded in larger multinationals.

Preferred solution/approach: Where it is found that a documentation requirement is disproportionate, it would be preferable to exempt the business from this obligation (or provide for a radical simplification). This does, however, not prevent that operations of any size should work at arm's length.

10. Triangular/multilateral MAP/AC cases

Issue: Difficulties or disputes arise between Member States that have to be solved under MAPs. However, these difficulties or disputes may arise because of transfer pricing imposed by a company situated in a third country (most often a non-EU Country). This is an important area that the Forum could explore further.

2. Member States subgroup contribution (November 2006)

There was a long discussion on this issue which started with the relation between the JTPF work and the OECD work. It was followed by a discussion on the different topics included in the Secretariat's paper and other topics suggested. This summary expresses the preliminary conclusions of the subgroup.

1. Relationship between the JTPF work and the OECD work.

It was agreed that there needs to be only one international standard but that does not mean that any work undertaken by the OECD has to be ruled out of the JTPF's work.

It has been proved in the last years that in fact the existence of one has made valuable contributions and influenced very positively to the other.

Neither the composition nor the countries or the focus of the work is the same. This implies that the EU reality with its special sensitivity might allow for further guidance and compromises than perhaps can be achieved in other forums.

Therefore the JTPF can supplement the OECD guidance. While repetition should be avoided it is recognised that there could be some overlapping of issues. However the focus can be different

and the JTPF should lead the way finding new issues where further guidance or compromises can be reached.

2. Comments on different topics.

2.1 Monitoring AC and the Code of Conduct.

Generally considered of vital importance. Is was considered an ongoing topic which would include point 4 of the Secretariat's paper on updating the AC. Different issues could be considered under this topic.1

2.2. Monitoring. Rest of subjects.

Keep in the working programme. The basic aim of the monitoring should be the peer pressure. However it will be useful to clarify whether there can be other use of the information handed to the Forum and how this monitoring takes place in the different areas proposed.

2.3. Centrally charged services.

MAP cases have often difficulties with this issue not only from the point of view of the substance (i.e. mark up) but specifically from the point of view of the standard of proof required to justify that a service has effectively been provided. The JTPF could therefore try and set up a common standard on the type of proof needed to support the invoicing of central services charges. This item was given maximum priority and had full support from members.

2.4 Exchange of practical experiences.

Under this heading any experiences that can become useful could be discussed and analysed. It could be limited to approximately one hour and the outcome could be very different from the above topics since the objective is merely to share information rather than producing a report. Some examples were given during the meeting and it was agreed that it should be kept in the work programme as suggested (limitation on time and nature of the document).

2.5 SME

It should be kept in the working programme. The scope of the work could consist in reducing administrative charges for SMEs although there was some concern on the possible discrimination treatment. Input and initiative from the business side is necessary.

2.6 Guidance on risk analysis or risk assessment

[1] To monitor the AC it is important to define "open-closed" cases and this shall be done under this mandate. France provided a paper and during the next pre meeting (being an issue that mostly concerns MS) it could be envisaged to get consensus. Other suggestions are welcomed.

There were some doubts on the actual meaning of the heading and the possible outcome of the work. However at the next meeting we could get some clarification in order to have a better understanding on this issue.

2.7 Multilateral MAP/ Arbitration

There was an example provided by Belgium and Germany that is worth revising to fully understand the problem. However some members expressed their view that this should be a low priority item.

2.8 Dispute resolution and avoidance.

There was a broad consensus in showing certain scepticism on the outcome of this work as described in the paper.

2.9 CCA.

This item did not receive much support from the subgroup although it any final decision was deferred to listen to inputs from the rest of the members.

2.10 Convergence of ALP with customs.

The issue did not raise much interest considering that customs in a European market do not make much sense. Furthermore OECD has started a similar project and in this case it could probably lead to repetition.

2.11 Safe harbours

Although the idea of providing safe harbours is a recurrent request from business, most members felt that setting up safe harbours in the field of transfer pricing might be extremely difficult. However, it was agreed that any precise proposals from the business would be welcomed and shall be looked at.

3. Comments from DOC.JTPF/030/REV2/BACK/2006/EN (November 2006)

Comments from The Netherlands:

The draft working program has not been discussed at the last JTPF meeting. From the June 2006 JPTF meeting we understand that it is the intention of the Bureau/ Secretariat that the new Forum, if any, will decide on its working program. We also understand that the Commission might decide during summer time on the renewal of the Forum after 2006. In this respect we like to provide you with our thoughts.

The Netherlands would support extenstion of the JTPF. Taking into account the work accomplished by the Forum (on the arbitration convention and documentation) and the difficulties arising from 4 meetings per year, the Netherlands considers 2 meetings per year sufficient to deal with the remaining issues to be discussed.

As regards the secretariat information note on the future work program (document JTPF/021/2006/EN), the Netherlands has the following remarks. We would support the monitoring work (par. 4.1.1), work for SME's (par. 4.1.3) and follow up of the Arbitration Convention work (par. 4.1.4). The Netherlands however is of the opinion that the Forum should not pursue any activities for which the OECD is better equipped. It is important that the Forum and OECD by no means go in any different way and in our view this risk is present if the Forum might pursue activities on technical issues. The Netherlands therefore does not agree on the idea of making "shorter, more focussed documents" on technical issues as taken up in par. 4.1.2 (triangular cases, CCAs). These are typically topics that should be taken up by the OECD and not the Forum.

In our paper of 26 February 2006 we have made some proposals that the Forum might consider. We suggested to discuss whether bilateral agreements between two tax administrations on an accepted range can result in a significant relief of documentation requirements for taxpayers. For example: an agreement that a cost plus within a certain range might be acceptable for specifically, narrowly described, elementary service activities. If such and agreement could be reached, then the taxpayer would no longer be required to perform a costly benchmark study if he uses this agreed range. Furthermore, cases of double taxation due to differences in domestic legislation will be limited. We would like to discuss whether the EU internal market might benefit from such an approach.

Another topic to be considered might be the use of databases. The use of databases in the EU causes problems for tax authorities and taxpayers. US databases however contain more information and are more usefull. The Forum might consider to discuss how European databases could be improved.

Comments from Poland:

As far as the „Secretariat information note on the future work programme" (DOC:JTPF/021/BACK/2006/EN) is concerned, Poland would like to present the following suggestions of topics on the future work of JTPF:

Exchange of practical experiences – technical discussion

From our point of view, exchanging of practical experience is extremely important in developing awareness of possible procedures in profit transferring especially in connection with highly complex transactions including transactions amongst MNE or involving intangibles.

It would be especially vital to discuss issues relating to:

a) Cost Contribution Arrangements and other agreements involving intangible property
b) Convergence of arm's length pricing of transactions for corporation tax purposes.
c) Incidence of the application of transfer pricing rules across the EU and developing some guidance about when a transfer pricing related audit is likely to be a worthwhile and cost effective endeavor for tax administrations.

Small and Medium sized Enterprises

Poland is interested a lot in examination the possibility of applying JTPF achievements to SMEs. However, it is essential to stress that in our opinion work should be focused only on limited types of complex transactions.

Follow-up of the Arbitration Convention in the light of the OECD work on arbitration and practical experience of arbitration cases

Poland is interested in developing further best practices on how the AC should work in practical terms. However, as Poland does not have any cases under the AC yet, we will not be able to give constructive remarks in this area.

Comments from Business members:

With regard to the potential future work programme, we can agree to the topics set forth in the "Secretariat Information note".

From our perspective, a further issue to be discussed in the EU JTPF could be the treatment of business restructurings which is obviously an issue which is discussed at the OECD level and intensively in Germany. The issue relates to the treatment of supply chain restructurings and the discussion of so-called business opportunities. Since e.g. the OECD and the German tax authorities are currently working on a statement paper and administrative principles respectively, it is in our view an issue of major importance which could be discussed in the Forum. Although it is certainly a topic which remains at the legal disposal of the Member States, it could be helpful to discuss the topic to - at least - examine the different perspectives between the member states.

Comments from a second Business member:

It is perhaps not as clear as it should be whether thin capitalisation issues are covered by the Arbitration Convention. They should be since Article 4 refers to “commercial or financial relations.” However, I believe that the work of the Forum did not clarify the matter. I believe that there is some difference across Member States about the extent to which transfer pricing matters incorporate thin capitalisation; for example, the UK legislation on transfer pricing incorporates thin capitalisation, other Member States have separate legislation, and some look upon the interest rate as within the transfer pricing rules but not the quantum of the debt. It is a confusing area. Where Member States have legislation, consistency of approach in relation to safe harbour rules and arm’s length principles appear lacking.
Recently the Advocate General published his option in the Thin Cap Group Litigation (C-524/04, 29 June 2006). Although this focussed on the UK’s thin cap rules, the AG also made two general points. In paragraphs 69 to 80 the AG maintains that there is an obligation on the country making the thin cap adjustment that a corresponding adjustment in the other Member State is obtained. Reciprocal recognition is a crucial part of the requirement that thin cap rules are applied in a way proportionate to their aim. It seems to me that ensuring that thin cap is covered by the Arbitration Convention is an important issue for the Forum to take up, since reciprocal arrangements would thereby be guaranteed.

Secondly, and this point goes wider than relevance to the Arbitration Convention, the AG indicated his clear preference for an arm's length test for thin cap, rather than a fixed criterion, such as a fixed debt-equity ratio. This would be an interesting area for the Forum to explore. How does one demonstrate arm's length debt levels, and how do the rules and approaches differ across, and how can these differences be minimised.

Comments from Ireland:

Ireland's comments on the suggested future work programme are as follows:

Monitoring of the two Codes of Conduct and the effectiveness of their implementation

The implementation of the Codes of Conduct is a matter for the Member States. Nonetheless, Ireland had no objection to the Forum examining difficulties identified in the operation of the two Codes of Conduct with a view to considering whether any modifications should be made to those codes. However, care would need to be taken as regards taxpayer confidentiality.

Exchange of practical experience – technical discussions

While there may be some value in the Forum discussing some technical issues, the approach suggested seems very open ended. It may be more appropriate to identify in any new work programme those areas that members of the Forum would wish to prioritise and focus on these.

Multilateral MAP/ arbitration cases and triangular MAP/arbitration cases.

Ireland had no objection to the Forum discussing this issue. However, if the issue relates to the interpretation of Article 25(3) of the OECD Model, it may be more appropriate to deal with it at OECD level.

Cost Contribution arrangements

Because this is a technical issue on which OECD guidelines already exist, this appears to be an area where work might best be carried out at the level of the OECD.

Disputes resolution and avoidance

This is an area in which the Forum has made a valuable contribution to date. Ireland is open to this being further pursued by the Forum. However, the issue of convergence of arm's length pricing for corporation tax and customs does not appear appropriate to the Forum. In addition, the question of when a transfer pricing audit should be carried out is a matter for tax authorities and does not seem relevant to the Forum.

SMEs

Ireland has no objection to the Forum examining this.

Further work on how the Arbitration Convention should work

Ireland has no objection to the Forum examining this.

4. Background information from DOC: JTPF/021/BACK/2006/EN (June 2006)

After its first mandate of two years of 2002, the JTPF was prolonged for a further period of two years ending in December 2006.

During the first mandate the Forum mainly discussed the Arbitration Convention and related mutual agreement issues. The agenda of the second mandate was quite ambitious and the following topics were supposed to be examined:

1. Examination of possible preventive measures to avoid double taxation: *carry-over of 2002-2004 work programme*
2. Acceptability of transfer prices to tax administrations (including APAs): *carry-over of 2002-2004 work programme*
3. Interest payments: *discussed but not finalised during 2002-2004; the Forum could identify the exact nature and extent of the problems of interest payments related to transfer pricing adjustments and examine the scope for solutions*
4. Penalties levied on transfer pricing adjustments: *discussed but not finalised during 2002-2004; the Forum could identify the exact nature and extent of the problems of penalties related to transfer pricing (excluding criminal penalties) and examine the scope for solutions.*
5. Certain aspects of the interaction of the mutual agreement and arbitration procedure with administrative and judicial appeals: *discussed during 2002-2004; the Forum could identify the exact nature and extend of the problems of this interaction and examine the scope for solutions*
6. The influence of accounting systems on transfer pricing: *the Forum could discuss and assess the consequences and possibilities of more harmonised and integrated accounting systems on transfer pricing*
7. Monitoring of the code of conduct on the arbitration convention and the ratification process of the Accession Convention.

Revising and Continuing the 2004 work programme

We can envisage that at the end of 2006, the JTPF will have examined the topics of possible preventive measures to avoid double taxation, APAs, penalties, interest payments and carried out monitoring of the first code of conduct. This implies a possible carry over of the issues of judicial appeals and accounting problems. However the Forum should decide whether these topics are still relevant and whether it is necessary to consider these topics in any new work programme.

Possible future work programme

In order to decide whether a renewal of the JTPF would be useful, all Forum Members were requested to send written contributions and these suggestions were discussed during the meeting of March 2006. These suggestions are outlined below.

After a first discussion and additional suggestions the following topics are proposed for examination:

1. Monitoring of the two Codes of Conduct and the effectiveness of their implementations

Taking into consideration that both Codes of Conduct invite Member States to report to the Commission on their implementation and the practical problems faced with their implementation, this topic is of course of major importance and must be considered as a continuous task of the JTPF. Furthermore, the Forum has an important role to play in checking how the suggestions and best practices developed by the Forum are being implemented across the EU.

2. Exchange of practical experiences – technical discussions

Several members of the Forum have suggested that the nature of the Forum's output could change to allow for shorter, more focused documents which concentrate on narrower, more detailed topics. These narrower topics might not lend themselves to a "code of conduct" or a similar instrument but nevertheless EU taxpayers would undoubtedly benefit from a discussion and publication of the Forum's conclusions on various topics.

It is envisaged that the programme could be slightly flexible here in order to allow for extra topics to be included if necessary. **However, topics so far suggested which would be discussed are:**

- **Multilateral MAP/arbitration cases and triangular MAP/arbitration cases.**

Three MS underlined that they faced problems resolving disputes where more than two countries were involved. The Forum could discuss how the application of Article 25(3) of the OECD Model Convention can resolve these situations.

- **Cost Contribution Arrangements (CCAs).**

This is a large subject covered by the OECD Guidelines on transfer pricing. However, it is possible that the Forum could usefully explore common approaches to CCAs within the EU. It has been suggested that a discussion could centre on why some MS permit a mark up on services charged through a CCA but some do not. Perhaps of wider interest is the question of what services would be charged for at arm's length and the standards of proof necessary to evidence a charge between associated enterprises.

- **Dispute resolution and avoidance**

This issue remains of great interest to the Forum and the next work programme could contain further elements under this heading. One MS has already suggested a form of prior consultation – "high level functional analysis" – and this could form the basis of a discussion aimed at developing this approach within the EU. Business member in particular are also interested in further developing prior notification, prior consultation and prior agreement.

- **Business members have suggested that the Forum could look at the convergence of arm's length pricing of transactions for corporation tax and customs purposes.**

- **It is also possible that the Forum could look at the incidence of the application of transfer pricing rules across the EU and perhaps develop some guidance about when a transfer pricing related audit is likely to be a worthwhile, cost effective endeavour for tax administrations.**

3. Small and Medium sized Enterprises (SMEs)

Some Member States suggested reviewing the different achievements of the JTPF to see how they might be applied to SMEs. Indeed it could be envisaged to establish specific practices or guidelines only applying to this type of company. In order to have fruitful debates, it would be desirable to consult with SMEs.

4. Follow-up of the Arbitration Convention in the light of the OECD work on arbitration and practical experience of arbitration cases

Time has moved on from the conception of the Arbitration Convention and the Code of Conduct. It is desirable that the experience of how real cases are being decided under the AC and the Code of Conduct continues to inform best practice in the EU. Therefore it is considered that the Forum could usefully consider developing further best practice on how the AC should work in reality.

A carry-over of last work programme remains the interaction of the mutual agreement and arbitration procedure with administrative and judicial appeals (article 7(1) and (3) of the AC. There is a direct link here to the OECD's work on dispute resolution which clearly states (albeit in a different context) that domestic legal remedies should no longer be available if binding arbitration is to be entered into. The Forum could consider whether it is desirable or necessary to align the two approaches.

Other developments at the OECD's Joint Working Group on Dispute Resolution could be discussed and some of the results of the OECD's Joint Working Group possibly taken into account by the Forum.

The definition of a serious penalty in the AC varies considerably between MS. Since incurring a serious penalty will deny access to the AC, it is desirable that this definition of a

serious penalty is considered by the Forum and ways of permitting not restricting access be discussed.

The Forum could also give some thought to issuing guidance on the nature of the Arbitration Panel's proceedings and how their deliberations should proceed.

Conclusion

The above work may well represent a work load that is ambitious considering the length of any possible new mandate. This may require some prioritisation of the work. It is also desirable that those members of the Forum who have requested specific areas of work should be prepared to contribute directly to the first drafts of working papers before they are considered by the whole Forum.

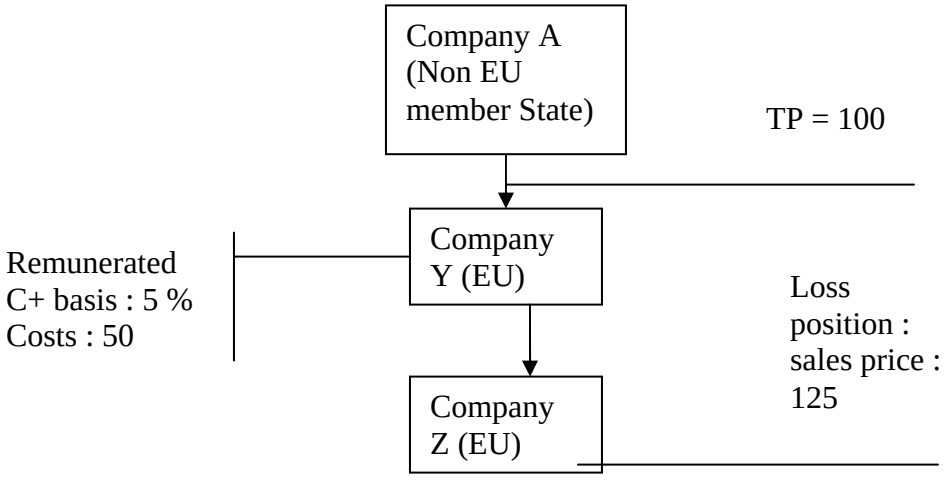
4. Background information from DOC: JTPF/007/BACK/2006/EN (March 2006)

BELGIUM

"Triangular" MAP cases

Difficulties or disputes arise between MS that have to be solved under MAP. However, these difficulties or disputes may arise because of TP imposed by a company situated in a third country (most often a non EU MS).

Example:



Facts : Company A is a non EU manufacturer of widgets. It sells its products to a local distribution/service centre (low risk, low function) in country Y. The distribution/service centre in country Y sells the goods to the end line distributor in country Z.

Company Z is in a loss position (for a long time). Company Y is in a profit position, but is only remunerated for its actual functions performed and risks assumed on a cost plus basis. Costs included in the cost base are for e.g. salaries, depreciation, …, but not the TP for the goods for the transaction between A and Y. The pricing between Y and Z is established on the following basis : pricing between A and Y + the cost incurred by Y and appropriate mark up .

E.g. assume the TP between A and Y is 100 (= non AL) and costs incurred by Y for the performance of functions and risks are 50 (= AL). A mark up of 5 % is added (= AL). Therefore, the price charged by Y to Z : 100 + 50 + 2.5 = 152.5. In the end, company Y only receives an AL-remuneration for its functions. The non-AL-price therefore has no effect on company Y. However, Company Z is only able to sell the widgets at a (market) price of 125 (= AL), leaving it with a loss of 27.5.

The dispute could be brought under the arbitration convention (and the arbitration commission) for the transaction between Y and Z company. However, under the MAP procedure, the competent authorities, and in the end the arbitration commission, could only establish that the remuneration of Y company is correct.

The problem here lies with the initial TP imposed by the non-EU company. It would therefore be advisable that both tax administration of Y and Z combine their efforts in order to tackle the problems that arise in A. Application of the arbitration convention would not solve the problem.
Advantages of combining the efforts of both competent authorities :

European countries would present themselves more as one “block”, applying the same principles and views;
Avoidance of double taxation at multilateral level;
Only one combined map procedure for the companies / group;
Transparency of the case for all the tax administrations involved : all could assist in the MAP between Z and A country.

Problems :

Do MAP procedures under DTA and AC allow this procedure ?
Acceptance of the procedure by other (non EU) countries ?

“Accounting”

There may be room for <u>additional guidance to be developed by the JTPF in the field of accounting</u>. The OECD-guidelines refer to accounting standards in several places, but the main idea that is worked out in the guidelines is that adjustments have to be made in order to :

- ensure the same type of costs are used (2.28)
- reach accounting consistency (2.39, 2.46, 3.9,)

Further, reference is made to the difficulties that arise in map due to i.a. different accounting systems that may lengthen the MAP process (4.52).

Further, when discussing CCA's, the guidelines state in 8.42 and 8.43 that the manner on how accounting principles are applied consistently to all participants in determining expenditures and the value of contributions is useful information.

However, the guidelines do not give guidance on how this consistency can be achieved, let alone applied.

Problems : specifically for Europe : 25 different GAP for statutory accounts;
For consolidated accounts : IFRS – Useful for MAP or MAP APA's ?
Consistent translation of a common accounting system (e.g. IFRS) into accounts useful for TP and that can be translated reasonably easy enough for use in domestic GAP.
Classification of certain expenses under of the three major cost groups identified by the OECD guidelines for TP purposes : common understanding of the cost groups and their content :

- Direct costs
- Indirect costs
- Operating expenses

This would not mean that the domestic GAP has to be changed, but for TP purposes a common basis could be applied.

The following (non exhaustive) list could serve as a guidance :

- Trade goods, raw materials;
- Services and miscellaneous goods;
- Wages
- Social security contributions
- Pensions and allocations to pension funds;
- Deprecations and reductions of value of
    - Tangible property
    - Intangible property
    - Preliminary expenses
- Reductions of value of
    - Stocks;
    - Orders;
    - Receivables
- Miscellaneous costs
    - Marketing
    - R&D
    - Market development study
- Exceptional costs
    - Exceptional depreciation and reduction of value (tangible and intangible property)
    - Reduction of value of financial assets;
    - Provisions for exceptional risks and costs;
    - Losses incurred as a result of the realisation of fixed assets
    - Restructuring costs

"Monitoring"

Monitoring of the COC on the arbitration convention and on documentation – e.g. evaluation of the COC after 6 months (perhaps too soon), one year, two years, …

FINLAND

At this time we have no specific suggestions, but would like to mention that we are generally very much in favour of continuing the work of the Forum, as it has been extremely beneficial for us. We are especially interested in the subjects of dispute avoidance and resolution as well as documentation.

FRANCE

Un suivi du devenir des travaux sur la documentation devra être initié par le Forum

GERMANY

1. Triangular MAP/arbitration cases

   There may be cases where a (bilateral) MAP or arbitration procedure between two countries is not suitable to resolve their tax disputes. This is the case where the underlying reason for double taxation in respect of two associated enterprises lies in non-arm's length transfer pricing between a third (often non-EU) associated enterprise of the MNE and one of the two enterprises suffering from double taxation. It seems that the OECD so far has not addressed this issue.

   Example:
   Company M in country M manufactures products and sells these to its European whole sale distribution subsidiary A in country A at cost 100 plus 20% profit mark-up, i.e. at a transfer price of 120. Subsidiary A sells these products on to an associated enterprise B in country B at cost plus 2% (arm's length) profit mark-up. Distribution Company B sells these products on to end customers and constantly makes losses. Following a tax audit at company B a transfer pricing adjustment is made on the basis of the resale price method to arrive at arm's length transfer prices (lower purchase prices) for the products purchased by company B from company A. This transfer pricing adjustment results in double taxation. A corresponding adjustment of country A would result in company A making losses. It follows, that while in a MAP or arbitration procedure between countries A and B double taxation may be eliminated, this could only be achieved at the expense of the tax revenue in country A and/or country B. This result, however, seems unjustified. A satisfactory solution to eliminate double taxation in such cases can only be a corresponding adjustment by country M.

2. Cost Contribution Arrangements (CCAs)

We find it difficult that CCAs, which by nature involve at least two countries, are governed by different rules in the EU. In our view the situation can be compared with bilateral/multilateral APAs where a common approach in the EU, e.g. best practice, seems to be very useful.

In addition, there are significant discrepancies between Member States' rules on CCAs. For example, some Member States require a profit mark up on the allocated cost, some other Member States disallow such a profit element in the context of certain administrative services. Double taxation is the inevitable consequence.

An issue related to CCAs is the influence of (commercial/tax) accounting on transfer pricing. The cost basis to be applied in a cost plus situation, e.g. for a CCA, differs from Member State to Member State because the accounting systems are not harmonised. In addition, some Member States require their national tax accounting system to be the basis for the cost plus method whereas others accept the commercial accounting system.

3. Monitoring and Revision of the Code of Conduct on the Implementation of the Arbitration Convention

An issue not to be considered as a separate topic for the future programme, but a continuous task of the Forum could be monitoring how the Code works in practice and considering a revision of the Code to improve its functioning. In our view, clarifications as regards the advisory commission, e.g. on the issues of timing and reasoned decision, could be envisaged. Also, the interaction of the mutual agreement and arbitration procedure with administrative and judicial appeals could be revisited (see Articles 7 (1) and (3) of the Arbitration Convention and point 2.5 of the JTPF's activity report from October 2002 - December 2003; Commission Communication of 23 April 2004 COM(2004) 297 final).

In the context of monitoring and revision, the developments at the OECD's Joint Working Group on Dispute Resolution could be discussed and some of the results of the OECD's Joint Working Group could be taken into account in a revision of the JTPF's Code of Conduct in order to align the two approaches to some extent.

The Forum has so far accomplished important work reflected in Commission Communications and proposals for Codes of Conduct on the implementation of the Arbitration Convention and EU

Transfer Pricing Documentation. Both issues were considered urgent by the Forum and, therefore, were given high priority.

The Forum's work on alternative dispute resolution procedures, in particular APAs, is expected to be finalised by the end of the Forum's second term. It seems to us that although there still remain important issues to be discussed in the Forum, none of these issues require urgent solutions. Considering that in 2002 it was originally agreed to have two or three Forum meetings per year, we therefore suggest reducing the number of meetings from 2007 onwards to no more than three per year.

ITALY

"Triangular" MAP cases

We have often experienced MAP cases with an EU country where disputes arise because of transfer pricing imposed by a company situated in a non EU country.

In the example by Germany, it is highly likely that the advisory commission charged with delivering its opinion on the elimination of the double taxation will perform its task by asking Country A to make a corresponding adjustment. As the advisory commission cannot deliberate towards Country M (non E.U. country) the double taxation will be eliminated at the expense of tax revenue in country A.

At the moment, we do not have any specific idea on how to solve this problem, but we think that it should be taken into consideration by the Forum as a challenging task to perform.

Arbitration Convention

In our view, the Forum should study some important issues concerning the interaction of the mutual agreement and arbitration procedure with administrative and judicial appeals.

We are mainly referring to Article 7, paragraph 1 and paragraph 3. In the code of conduct, it has not been clarified the starting point of the two years when the taxpayer has recourse to the remedies available to it under internal law of a country which cannot derogate from the decisions of their judicial bodies. Among the countries which the situation in paragraph 3 applies to, a few countries issued specific guidelines in that respect, while other countries did not issue any circular (nevertheless they have of course their position on that).

The interaction of the mutual agreement and arbitration procedure with administrative and judicial appeals is of course an internal matter and the Forum cannot have any influence on that. Nevertheless, it could be extremely useful to know the different positions of the countries and what can happen when the positions are different. Knowing that in advance could accelerate the solution of problems between Competent Authorities and could also give the taxpayer some useful indication on the timing and on the result of its request.

Number of meetings

We suggest reducing the number of Forum meetings to three per year.

MALTA

We would like to suggest that the JTPF addresses, in a future mandate, the question of transfer pricing and SME's. Up to now, this issue has been largely considered in the margins. Considering that the vast majority of enterprises within the EU fall within this category, we feel that the JTPF should give it its due consideration. A number of points come to mind such as:

1. Definition of SME (whether for transfer pricing, the already determined EU definition is adequate);
2. Whether SME domestic transactions should be subject to transfer pricing rules (I believe the UK exempts SME's from rules in respect of UK transactions);
3. The application of safe harbours;
4. Transfer Pricing methods which would be sufficient/acceptable for SME's;
5. The level of documentation requirements.

It is generally an accepted principle that SME's should carry a smaller burden when it comes to transfer pricing, but discussions during the JTPF meetings have shown that this issue is not that straight forward.

I am attaching herewith a copy of the Australian Taxation Office guide entitled "A simplified approach to documentation and risk assessment for small to medium businesses" which you may find helpful in relation to this subject. I would like to point out that the submission of this document should not be taken to mean that we necessarily agree with the contents of this document or that it is a suggestion that the Forum should in any way adopt it or the principles contained therein. It is being sent solely to aid the Secretariat in its research should this subject be taken on board.

Furthermore, we would like to point out that a fruitful discussion on this subject may not result if the Forum has no representation of SME's.

PORTUGAL

Portugal thinks that the Forum might have a role on accompanying application of transfer pricing rules in the EU. It seems however that there is no scope for more Codes of Conduct, and penalties should not be considered a possible object of any kind of Code of Conduct. Two meetings a year seem sufficient for accompanying the above mentioned subject.

SLOVAK REPUBLIC

Future of the JTPF: The Slovak Republic appreciates the professional work carried out by the Joint Transfer Pricing Forum and its efforts in order to improve the situation in relation to transfer pricing issues within EU Single Market. The Forum has already made more than we awaited and for us it is necessary to have a sufficient time and space in order to implement its outcomes in a reasonable way. Therefore, for this moment, the Slovak Republic does not submit any suggestions to the future of the JTPF

SPAIN

Finalisation of the work programme already agreed.

There is still some work to be finalised on issues approved. We need to revise the issues pending and see the feasibility of productive work on them.

Cost contribution arrangements.

MNEs have to deal with different CCA rules in the EU if they want to conclude a CCA. And there are significant discrepancies such as:

Some member States require a profit mark up on the allocated costs, some other disallow such a profit element in most cases.

The cost basis to be applied in a cost plus situation differs from MS to MS.

Influence of national accounting systems. Our aim is not to influence on national accounting systems but to develop further a common classification which could be applied for TP issues, mainly CCA.

All these may lead to double taxation and the Forum could explore practical ways to overcome these problems.

Although our proposal is initially focused on CCA s we understand there is room for further common guidance which may go beyond CCA. Therefore we could discuss the scope for this work.

Multilateral MAP cases within Europe.

More and more frequently there are case which concern more than two countries. There is an adjustment in country A and it affects countries B,C,D.

It is frequent that the issues discussed are of the same nature and the adjustments proposed have common reasoning.

In those cases 3 bilateral MAP cases without any communication among tax authorities may be burdensome for the taxpayer and may delay the process and the elimination of double taxation considered globally.

In those circumstances, following the experience we have on multilateral APA (which has proved to be very successful) we might want to explore if on a voluntary basis there is room for MAP cases to improve on the basis of common negotiation (either during the whole process or partially when considered convenient).

Other issues.

Spain would support working on other issues that may increase common approach even if the work may not necessarily result in a Code of Conduct or a Code of best practice.

Cross-border mergers in future in the EU will lead to an increasing number of PEs which were formerly subsidiaries of the MNE.

In this context the rules for the transformation and also future taxation of the sub/PE, as well as transferral of assets, are important issues.

Although the OECD is carrying out an important project on PE, we believe there is margin for the EU to agree on a common interpretation based on the OECD work which might lead to agreed points of view on this important issue.

We could even explore whether this project could have a wider scope which included business restructuring although the OECD is carrying out work on this issue.

We also believe a project on SME and transfer pricing might be valuable. The project could consist of an analysis of those aspects that may be specially burdensome for SME and propose practical common solutions that may be applicable when there is low risk at stake.

UNITED KINGDOM

The UK thinks that the Forum has so far done valuable work in producing Codes of Conduct on Dispute Resolution and on Documentation. Promising work is also being done on Advance Pricing Agreements. The UK wonders, however, whether there is scope for many more, if any, Codes of Conduct. The scope is limited without getting into areas that are the responsibility of the OECD. Discussions so far on penalties do not suggest that a Code of Conduct will be a likely

outcome of that exercise.

A useful future step for the Forum might be to have a general discussion, not linked to specific issues, about current developments in applying transfer pricing rules in Europe. This would be a particular opportunity for the business representatives to give their impression. It is possible that some specific ideas for future work would emerge from such a discussion.

If it appears that the scope for the Forum to produce new outputs, such as Codes of Conduct, may be diminishing, the Forum might want to consider having fewer full meetings. It seems unlikely that there will continue to be a case for having four meetings a year. The Forum might want to consider reducing to two meetings a year.