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TAXATION AND CUSTOMS UNION  
Direct taxation, Tax Coordination, Economic Analysis and Evaluation  
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## **EU JOINT TRANSFER PRICING FORUM**

### **BUSINESS MEMBER CONTRIBUTION ON AVOIDANCE OF DOUBLE TAXATION UNCERTAINTIES**

**Meeting of 10 February 2010**

**Centre de Conférences Albert Borschette  
Rue Froissart 36 - 1040 Brussels**

# Memo

To: Secretariat EUJTPF  
From: Monique van Herksen/Bernard Damsma/Zoltan Liptak  
Date: 17 January 2011

Dear Secretariat,

Considering that a returning agenda item of our EUJTPF meetings consists of monitoring the workings of the Arbitration Convention, it may be appropriate to raise an issue that we see clients/taxpayers run into more often in certain jurisdictions. This regards the uncertainty taxpayers have as to whether they have access to avoidance of double taxation (and arbitration) when they take action to address a (proposed) transfer pricing adjustment.

In particular a concern regards situations where taxpayers are *-de facto* and for all practical purposes- confronted with an offer to settle a proposed domestic adjustment at the level of the (domestic) tax inspector on the condition that they give up access to the mutual agreement procedure. An unfortunate consequence of this offer is that the taxpayer most likely loses the opportunity to get relief from double taxation with respect to the (ultimate) adjustment and settlement amount through the competent authority mechanism.

## Issue

When a (transfer pricing) adjustment is proposed, a taxpayer has several potential avenues to address the proposed adjustment:

1. In several jurisdictions, the taxpayer can immediately file for avoidance of double taxation with the competent authorities under the Arbitration Convention. Here the chances for full application of the Arbitration convention are probably best;
2. If no administrative domestic objection procedure applies, or the taxpayer decides to not file a domestic administrative objection, the taxpayer can file a *formal appeal* with the judiciary, if the case is timely filed. The case may be resolved by the judiciary domestically if the judiciary agrees with the taxpayer, or the case may result in a judgment that includes an adjustment against the taxpayer.<sup>1</sup> In this latter scenario, if a subsequent avoidance of double taxation request is filed, such will often be limited to a request for correlative relief for the ultimate adjustment and there is no access to the arbitration phase of the Arbitration Convention based on Article 7(3) of the Arbitration Convention. Alternatively, it may be held that there is no access to the mutual agreement procedure for the amount of double taxation resulting from the judiciary decision;
3. File an *administrative* objection (if applicable) under domestic law and see whether the issue can get resolved that way. If a domestic administrative appeal is honored and accepted, the proposed adjustment may be reduced or perhaps even revoked. It would seem that the remaining (reduced) final adjustment should qualify for access to the mutual agreement procedure or the arbitration phase of the Arbitration Convention. A caveat may be applicable here, as it is not entirely clear whether any of the competent authorities of the EU Member States would deem the outcome of the administrative objection a binding decision ( "*a decision by their judicial bodies*" as mentioned in Article 7(3) of the Arbitration Convention), however. The Code of Conduct (2006/C176/02) does refer to a "final decision of the tax administration on the income" "*or its equivalent*" in paragraph 3.3 (a) of the 2006 COC regarding the exchange of position papers, and if the outcome of an administrative appeal qualifies as such, there seems to be full access to the competent authority process under the Arbitration Convention but it appear not to have been explicitly addressed and therefore it is not entirely clear whether an administrative appeal and decision would qualify in full for avoidance of double taxation under the Arbitration Convention and whether ;

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<sup>1</sup> The possibility of appeal to the highest court is for all practical purposes deemed included in this "formal appeal."

4. Where the taxpayer is informed of an imminent proposed adjustment by the competent tax inspector, gets into a discussion with the tax inspector on the proposed adjustment, and is informed that the proposed adjustment can be significantly reduced, provided the taxpayer forfeits access to the mutual agreement process or any appeal opportunity. In other words, if the taxpayer will not involve any other (higher) level of review of the proposed adjustment, a discount of the proposed adjustment is available. This settlement option may be proposed before a final adjustment is issued or right after, during the time the taxpayer has to appeal the final adjustment under domestic law.

The time period a taxpayer has to settle/appeal a transfer pricing adjustment is usually quite short and does not allow for extensive consideration of all the consequences of picking one route over another. The above outcome (settlement) generally leaves a taxpayer with double taxation.

It should be noted that in countries where penalties for asserted delinquent transfer pricing are linked to the final (Euro) amount of the adjustment, it is attractive for taxpayers to resort to this fourth option, as a discounted adjustment may very well avoid or significantly decrease related penalties.

Some taxpayers will simply incur the costs of double taxation if no relief is available, yet it cannot be excluded that others may actually want to make use of a (self-administered) compensating adjustment to allow for a matching result. The compensating adjustment could be implemented in the year under audit by filing an amended return, but as that year may be closed in the foreign jurisdiction, the taxpayer could also consider taking the compensating adjustment in a later year in the foreign jurisdiction.

#### Discussion

The summary description of the above avenues and their consequences discloses that avoidance of double taxation is not always readily and easily available, and that a taxpayer with all best intentions, may inadvertently close access to avoidance of double taxation depending on what avenue is pursued.

Also, the quickest solution (time wise) to get a proposed adjustment “settled” (which is probably the 4<sup>th</sup> avenue) is unfortunately the avenue least likely to result in avoidance of double taxation, as the settlement is usually explicitly conditional upon not requesting avoidance of double taxation. Separate and apart from the question whether the tax inspector may legally be able to deprive a taxpayer from access to the avoidance of double taxation under the Arbitration Convention (or a treaty for the avoidance of double taxation, for that matter) another issue that may arise is that if a taxpayer reached agreement with a local tax inspector regarding an adjustment, the competent authority of the country on the other side of the transaction may be reluctant to entertain a mutual agreement procedure based on the position that the adjustment is the result of a settlement (and perhaps in extreme cases even be considered a “voluntary payment”). The 1st option (giving up the domestic relief possibilities and going directly to the Mutual Agreement Procedure) is the one that today still offers little certainty because there is evidence of cases being characterized as not qualifying for relief under the arbitration phase of the Arbitration convention and there is also some evidence of other cases not being resolved in the Mutual Agreement Procedure.

Separate and apart from the uncertainty, if a taxpayer decides to claim relief for a unilateral settlement itself by claiming a correction in the earnings of the related party at the other side of the transaction, the inflexibility of one tax authority becomes the burden of the other tax authority, without it having had a chance to determine the arm’s length nature of the adjustment.

As avoidance of double taxation is seen as crucial both by the EU Commission and by the OECD, it would seem that there should be at the least an instruction disproving of the offering of settlements conditional upon not seeking relief from double taxation. Second, it would seem that the avenues that close or reduce access to avoidance of (full) double taxation could be more clearly delineated and disclosed, perhaps in a follow-up EUJTPF survey, so that taxpayers up front are aware of the consequences of their decisions. We appreciate raising this issue and your consideration of the issue presented.