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Milan, April 28, 2003

To the Members of the EU Joint Transfer Pricing Forum

Dear Members,

As agreed at the last meeting of the EU JTPF, please find hereby the memorandum concerning the interplay between internal judicial proceedings and the procedure under the Arbitration Convention (hereinafter “AC”). In particular, this memorandum focuses on the interpretation of Article 7(1), second subparagraph, and Article 7(3) AC. The memorandum represents the opinion of the business members of the JTPF.

1. Article 7(1), second sub-paragraph, AC

1.1. Article 7(1) AC stipulates that:

“1. If the competent authorities concerned fail to reach an agreement that eliminates the double taxation referred to in Article 6 within two years of the date on which the case was first submitted to one of the competent authorities in accordance with Article 6(1), they shall set up an advisory commission charged with delivering its opinion on the elimination of the double taxation in question.

Enterprises may have recourse to the remedies available to them under the domestic law of the Contracting States concerned; however, where the case has so been submitted to a court or tribunal, the term of two years referred to in the first subparagraph shall be computed from the date on which the judgment of the final court of appeal was given”.

1.2. Article 7(1), second sub-paragraph, AC provides that internal judicial proceedings and the Arbitration Convention procedure are in principle independent and recourse to the Arbitration Convention does not rule out internal judicial proceedings.

1.3. **The independency of the two remedies (AC and internal judicial remedies) is however only apparent insofar as – in the event that the internal judicial remedy is activated – the most important phase of the AC (the setting up of the advisory commission) may be pursued only after the internal judicial remedy has been exhausted [see the condition laid down by Article 7(1), second sub-paragraph, AC].**

1.4. Indeed, should the enterprise file an appeal before a judicial court against the tax assessment leading to the alleged double taxation, Article 7(1), second sub-paragraph, AC stipulates that the two-year time period for the setting up of the advisory commission does not run as from the time the case was submitted to the tax authorities under Article 6(1) AC. In such a case, the said Article 7(1), second sub-paragraph, sets forth that such two-year period starts to run once the decision of the final court has been rendered. In other words, the running of the two-year period is suspended until the issue of the decision of the final court.

1.5. **Article 7(1), second sub-paragraph, AC creates a significant drawback to the operation and effectiveness of the entire AC; indeed, (unless the taxpayer withdraws his right to internal judicial remedies) it makes the duration of the AC proceedings equal to: (i) the duration of the internal judicial proceedings ending with a final judgment; (ii) plus two years; (iii) plus the six months available to the AC advisory commission to deliver its decision.**

1.6. **In any event, Article 7(1), second sub-paragraph, AC must be strictly interpreted.** This does not seem to have always been the case. For instance, the Dutch tax administration¹ has ruled that such a suspension of the two-year period applies “until the tax assessment has become irrevocable”. In particular, the Dutch tax administration argued that the two-year period is suspended both in the event the tax assessment is appealed in front of a judicial body, and in case the taxpayer files a notice of objection with the tax inspector. Similarly, the German tax authority is of the opinion that the two-year period is suspended if the administrative appeal (“*Einspruch*”) is activated by the taxpayer, neglecting that such administrative procedure is not a judicial procedure. On a proper construction of Article 7(1), second sub-paragraph, AC, such an interpretation is to be rejected since it conflicts with the wording of the provision, which makes reference only to the recourse by the enterprise to a “court or tribunal”.

2. Article 7(3) AC

2.1. Article 7(3) AC provides that:

“3. Where the domestic law of a Contracting State does not permit the competent authorities of that State to derogate from the decisions of their judicial bodies, paragraph 1 shall not apply unless the associated enterprise of that State has allowed the time provided for appeal to expire, or has withdrawn any such appeal before a decision has been delivered. This provision shall not affect the appeal if and in so far as it relates to matters other than those referred to in Article 6”.

¹ Decree of the Under-minister of Finance, dated October 13, 1997.

2.2. Article 7(3) AC considers situations in which the taxpayer is requested to withdraw his right to initiate and/or exhaust the internal judicial remedies as a condition for the activation of the second phase of the AC procedure. This constraint applies exclusively to the Contracting States whose domestic rules do not allow their competent authorities to derogate from the decisions of their judicial bodies.

2.3. France and the United Kingdom have declared that they will avail themselves of Article 7(3) AC in the context of the unilateral declarations under the Arbitration Convention. In any case, it cannot be excluded that other Contracting States could claim the application of Article 7(3) AC. **In order to provide enterprises with more certainty, each Contracting State should expressly state, in respect of its own jurisdiction, whether Article 7(3) AC prevents the recourse to the advisory commission phase and upon which circumstances.**

2.4. In this respect, it should be clarified that the election laid down by Article 7(3) AC may be exercised only by the Contracting States whose internal laws create a constraint upon the tax authorities to deviate from the decision of their judicial bodies when implementing the outcome of the Arbitration Convention procedure.

3. Conclusive remarks

In the light of all the above, the following conclusive remarks are drawn:

- (i) *Strict interpretation of Article 7(1), second sub-paragraph, AC.* Article 7(1), second sub-paragraph, AC should be strictly interpreted; particularly, it should be clarified by each Contracting State that the two-year period is not suspended in the event that the taxpayer files a notice of objection with the tax inspector or lodges an appeal with an administrative body. In order to provide enterprises with more certainty, each Contracting State should expressly state at what point an administrative appeal turns into a judicial appeal.

- (ii) Election for the AC procedure should not create disadvantages to the taxpayer. Article 7(1), second sub-paragraph, AC creates a strong incentive for taxpayers to withdraw their right to internal judicial remedies and opt for the AC immediately after the tax assessment has been issued, so that the two-year period may start to run immediately. For this reason the withdrawal of internal judicial remedies should not create disadvantages to the taxpayer. Furthermore, if double taxation is not removed (or, alternatively, if the advisory commission has not rendered its opinion) within a four-year period starting from the request of the taxpayer to the tax authorities under Article 6(1) AC, then the taxpayer should regain access to internal judicial remedies.
- (iii) Remedies for suspension of tax collection available also under the AC procedure. Particularly, such disadvantages include the right to obtain the suspension of the collection of taxes, which may be available under internal law judicial proceedings, but which is not equally available in the event that the taxpayer is acting only under the AC. In some Member States (for instance, Spain and Italy), the suspension may be granted by a tax court and not only by the tax authorities, which assures a third party objective decision. Such judicial right to obtain the suspension should be preserved in the event the taxpayer opts for the AC².
- (iv) Application of taxpayer's rights available under internal judicial remedies to the AC procedure. Moreover, due to the circumstance that the taxpayer is not a party to the AC procedure, some rights that are granted in the context of internal judicial proceedings are not preserved under the AC procedure. These rights could include, for instance, the right to support the arguments made by the parties (tax authorities) before the advisory commission, the right to a fair computation of the interest on late tax payments, the right to post-award controls, and the right to ask and obtain witnesses to be heard. The lack of these rights could further exacerbate the disadvantages to the taxpayer stemming from the withdrawal of internal judicial remedies. In order to eliminate such disadvantages, the parties or the advisory

² The suspension of tax collection was also favoured by the Opinion of the Economic and Social Committee on the 1976 Commission's Proposal of a Draft Directive (*Official Journal* C 18, 23.01.1978).

commission could agree to the application to the AC proceeding of the national rules of procedure which, as the case may be, are most favorable.

- (v) Automatic suspension of tax collection under the AC procedure. Article 7(1) AC sets forth a two-year time limit for the setting up of the advisory commission, whereas Article 11(1) AC requires that the advisory commission's opinion be delivered within six months from the date on which the matter was referred to such a commission. Since there is no obligation of the advisory commission to hold its first meeting within a prescribed time limit, the six-month period within which the commission should deliver its opinion is deprived of any significant value. Indeed, the deadline for the delivery of the opinion is, in practice, equal to ? days or months, plus six months. In order to reduce the adverse consequences arising from the excessive duration of the AC procedure, where tax collection is not suspended under internal law, the suspension of tax collection should automatically operate in the event that the advisory commission does not hold its first meeting within three months from the date of the expiry of the two-year period (in order to totally eliminate the adverse consequences of the delay in holding the first meeting, suspension of tax collection should always be granted under the AC procedure).
- (vi) Suspension of the accrual of interest for late payments under the AC procedure. Further to the above, the use of the AC procedure by the taxpayers could be fostered if the Member States accepted in their respective domestic laws that the accrual of interest for late payment be suspended while the AC procedure is in place. This decision could not be considered as discriminatory (as opposed to what happens if the taxpayer opted for an internal judicial procedure), but reasonable, since the AC procedure entails a negotiation between two administrations, rather than a confrontation between the opinions of a taxpayer and a tax administration on a given case, and the time it takes the negotiators to come to an agreement should not be at the expense of the taxpayer. As a matter of fact, if there is no accrual of interest for late payment during the AC procedure, both States involved will likely be incentivated to speed-up the termination of the negotiation and, at the same time, such non-accrual will eliminate another term for discussion (*i.e.* what the extent of the bilateral adjustment

is for the State accepting it, bearing in mind that the legislation ruling on the imposition of interest for late payment is an area of domestic law which is not harmonized).

- (vii) Official declarations as to the applicability of Article 7(3) AC with regard to each Contracting State. In any case, in order to provide enterprises with more certainty, each Contracting State should expressly state, in respect of its own jurisdiction, whether the application of Article 7(3) AC prevents the recourse to the advisory commission phase and upon which circumstances. In this respect, it should be clarified that the election laid down by Article 7(3) AC may be exercised only by the Contracting States whose internal laws create a constraint upon the tax authorities to deviate from the decision of their judicial bodies when implementing the outcome of the Arbitration Convention procedure.

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Sincerely yours,

(Guglielmo Maisto)