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EU JOINT TRANSFER PRICING FORUM

EU MONITORING PROCESS ON THE EU ARBITRATION CONVENTION AND EU TRANSFER PRICING DOCUMENTATION

FEEDBACK ON ACHIEVEMENTS OF THE EU JOINT TRANSFER PRICING FORUM BY THE BUSINESS COMMUNITY

Document prepared by the Business Members of the JTPF

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EU Monitoring Process on the EU Arbitration Convention and EU Transfer Pricing Documentation: Feedback on achievements of the EU Joint Transfer Pricing Forum by the business community

During the period of its first mandate the EU Joint Transfer Pricing Forum (hereafter referred to as EU JTPF) developed two Codes of Conduct which were adopted by the EU Commission and the European Council:

- Code of Conduct for the effective implementation of the Arbitration Convention (90/436/EEC of 23 July 1990) – see OJ C/2006/176/8 of 28 July 2006; and
- Code of Conduct on transfer pricing documentation for associated enterprises in the European Union (EU TPD) – see OJ C/2006/176/1 of 28 July 2006.

The Forum has considered the monitoring of the implementation of the Code of Conducts as a topic of major importance and a continuous task of the EU JTPF. The monitoring of the implementation of the Code of Conduct on transfer pricing is already mentioned in the resolution of the Council on the EU Transfer Pricing Documentation.

Various business members (Theo Keijzer of Shell through BusinessEurope and its member organisations, Monique van Herksen of Baker&McKenzie, Heinz-Klaus Kroppen of Deloitte, Eduardo Gracia of Ashurst, Guy Kersch of Grant Thornton, Guglielmo Maisto of Maisto e Associati and Dirk Van Stappen of KPMG) consulted their respective networks or correspondents to collect information and input on the experiences and remarks of the business community on the implementation of the Code of Conducts as well as on the actual application of the EU Arbitration Convention and the EU Transfer Pricing Documentation (see respective documents in this respect).

Based on the input received from the various networks within the business community, the following conclusions and areas of concern/points for further consideration have been listed and are highlighted below.

A. Arbitration Convention

Generally, the experience with the EU Arbitration Convention seems to be limited, even if there is a positive attitude towards this instrument. One of the explanations for the limited experience is that the EU Arbitration Convention procedure is still perceived by business to be too time-consuming and not in line with the current preference of early certainty/assurance (SOX/FIN 48 reporting).

The work of the EU JPTF is felt to have been vital in helping to ensure that the EU Arbitration Convention has been properly ratified. The Code of Conduct has also been useful in enabling transparent access to the EU Arbitration Convention.

In most of the EU Member States, the EU Arbitration Convention is accepted and the competent authorities (CAs) are working to manage the timely response and to

acknowledge the procedure set forth in the Code of Conduct on the Arbitration Convention. However, in most of the cases the experience is that the authorities are lacking resources and are thus not always able to comply with the time frame set forth in the Code of Conduct. It seems that tax authorities meet infrequently and for example do not use technology such as video conferencing to progress issues.

Because the EU Arbitration Convention guarantees certainty on an issue (within the EU), it seems to act as a good discipline on tax authorities and indeed business to seek to resolve matters without formal use of the EU Arbitration Convention. This could be a reason why until now only in rare cases the second phase of the EU Arbitration Convention was initiated.

The main areas of concern/points for further consideration by the EU JTPF are mentioned below:

- A first issue concerns the interpretation of Article 7(1), second subparagraph, of the EU Arbitration Convention where it is provided that *"where the case has been submitted to a court or a tribunal the term of two years referred to the first subparagraph shall be computed from the date in which the judgement of the final court of appeal was given"*. According to such provision the two years term in which the CAs should find an agreement before the setting up of the advisory commission is suspended if the case has been submitted to a court or a tribunal. Some Member States do not interpret this provision in a strict way. For instance, the Dutch tax administration still argues that the two years period is suspended also in case the taxpayer files a notice of objection with the tax inspector (that it is not a court or a tribunal). Even if it is expected a new ruling of the Dutch tax authority for the end of the year on this issue, it could be worth for all the Member States to have an official clarification of the EU JTPF on that point. Please note that this issue has already been raised in the past (see DOC: JTPF/010/BACK/2003/EN), but so far no solution has been found.

- With respect to the setting up of the advisory commission, the business community feels that it should be set up within X (e.g. 6) months from the end of the two year period. Certainty on this timing issue will speed up the whole procedure and thus make the EU Arbitration Convention a more workable tool.

- Another issue with respect to the advisory commission concerns the interpretation of the criteria of independency to choose the members of the advisory commission. Indeed, some Member States believe that tax consultants or directors of private companies can not be appointed since these persons do "not offer a sufficient guarantee of objectivity for the settlement of the case or cases to be decided". Also on this point, one should consider to have an official interpretation of the EU JTPF valid for all the Member States.

- Member States should try to reach common views on the interpretation of some provisions of the EU Arbitration Convention (thin capitalization; for new Member States: when a case can be considered as covered by the EU Arbitration Convention; etc). In this respect it would be advisable that Member States agree that where a significant majority of Member States has the same interpretation, the other Member

States will apply this rule. The business community feels that having a consensus on interpretation issues is of major importance.

- There seems to be an attitude of the Member States to not call the parties during the MAP stage. This is felt to be a negative element because the taxpayer's views and knowledge of the case could well contribute to expedite the process.

- As with the EU TPD concept (please see also below), there is a problem regarding the use/acceptance of pan-European comparability analyses. In a number of Member States pan-European comparables studies are not accepted and instead local comparables are required in the course of the audit preceding the procedure under the EU Arbitration Convention or the procedure itself.

- Apart from a case reported in one Member State, there seems to be no cases where access to the EU Arbitration Convention was formally and finally denied. In some cases/certain Member States there were, however, noted increased formal requirements. In addition cases were reported in certain Member States where the taxpayer has been requested by the tax authorities to agree not to apply for the EU Arbitration Convention as a condition to settle the case locally (see also comments below on serious penalties). It is clear that the latter cases/practices should be avoided as much as possible.

- Although during the last meeting, serious penalties were not deemed to be an issue according to the Member States, some cases/countries have been reported by business whereby the levying of serious penalties (sometimes being defined very broadly – e.g. including administrative penalties) bars the access to the EU Arbitration Convention. In practice, it appears that sometimes the threat of assessment of penalties based on bad faith is used by tax authorities of certain Member States during the discussions/negotiations with taxpayers, disabling the latter to obtain relief from double taxation.

- The deviating interpretation of appropriate transfer pricing methodologies and/or the use of interquartile ranges – based on the respective domestic transfer pricing laws/regulations – have created issues in the discussion of the cases in first phase of the EU Arbitration Convention.

- There seems to be a general understanding that the CAs involved try to cope with the deadlines to the extent possible. However, it is felt that it could be helpful considering other means of mutual dispute solutions such as mutual audits, etc. in order to avoid lengthy processes under the EU Arbitration Convention or respective Double Tax Treaties (in cases of non-EU Member States).

- New Member States that have recently signed the protocol on the accession to the EU Arbitration Convention have not gathered much experience yet. Obviously, taxpayers are not yet fully aware of the EU Arbitration Convention.

B. EU Transfer Pricing Documentation (EU TPD)

Currently, there is no significant experience available how the tax authorities audit the EU TPD approach since the Code of Conduct on documentation is still relatively new. However, it seems that the EU TPD is seen as useful tool in preparing a consistent documentation package for a multinational group of companies.

It is generally felt that the EU TPD is an extension of what was done informally anyway, i.e. prepare a master or template document for the main territory and then use this as the basis for local reports. It is thus conforming to the best practices that were already applied before the Code of Conduct was issued and that were actually considered in the course of discussion of the Code of Conduct by the EU JTPF. However there seems to be some confusion about the terminology used by the various players on the market. When using terms as 'EU TPD', 'Masterfile', 'Global Core Documentation', etc., few people seem to be aware of the existing differences in underlying content and relating benefits and/or pitfalls, that exist between the various concepts. It also appears that certain players on the market misuse or abuse the terms 'EU TPD' and 'Masterfile' and sell these so-named documentation files with the relating deemed benefits, but are de facto selling 'One size fits all reports', which do not meet the requirements of the EU TPD concept as laid down in the Code of Conduct and thus not provide the same deemed benefits.

The strict concept as foreseen in the Code of Conduct seems to narrow the EU TPD concept to companies with a centralized structure and rather homogenous flows of transactions while in cases of more decentralized structures the concept is not the preferred option, as it may even create extra coordination costs actually exceeding the benefits of the concept.

The main areas of concern/points for further consideration by the EU JTPF should be summarized as follows:

- The content requirements of the Masterfile and country files are from an overall point of view seen as useful. However, more specifically the requirements are in a number of Member States above the prerequisites as laid down in the domestic laws and/or regulations on transfer pricing documentation. In these cases the EU TPD is felt to be too demanding and thus creating an obstacle for the companies applying the concept. Business also stresses that the compliance costs remain high. Complying with the EU TPD remains still a very time consuming and costly exercise. Groups do not always have sufficient (internal and external) resources to implement the documentation, especially the country specific documentation, in the level of detail as prescribed by the Code of Conduct. In addition the main concern about the EU TPD seems to be the potential provision of unnecessary information to the tax authorities (why is it necessary to explain the entire business process in a country where the group has a simple distributor?).

- In some cases/Member States tax authorities still do not seem to accept a Masterfile prepared in another language than their own language. This practice is felt to constitute a considerable obstacle for the use of the EU TPD.

- It has also been expressed that the EU TPD requirements are too abstract and should be tailored to the need of the individual cases. The current documentation guidance is felt to be unattractive since in quite a number of cases it does not reduce the compliance burden. Also the necessity to provide information on APAs and business restructuring is felt to be a constraint and thus constitutes an obstacle to really implement the EU TPD concept.

- A number of Member States still require or at least strongly favour local comparables over pan-European comparables. It has often been the case that the tax auditors were not willing to accept the pan-European comparability analyses and instead asked for local analyses. As such still too much weight is placed by tax authorities on geographic comparability and way too little weight on other factors. Therefore, there seems to be an area of discussion as the Code of Conduct refers to pan-European comparability analyses and accepts these examinations.

- In some Member States there are also issues arising from the circumstance that local GAAP figures are required and the EU TPD is based on the GAAP applied for the group of companies. This could lead to a recalculation of the analyses.

Business Members of the EU Joint Transfer Pricing Forum
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