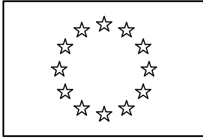

EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Analyses and tax policies
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SUMMARY RECORD OF THE TWENTY-FOURTH MEETING OF THE EU JOINT TRANSFER PRICING FORUM

held in Brussels on 24 March 2009

1. GENERAL INTRODUCTION

The Chair opened the session by informing the members that the Business members mandate was renewed on 1st March 2009 for two years. One business member did not ask for a second mandate and his replacement is Mr Andrea Bonzano who is responsible for transfer pricing in FIAT.

The agenda (doc.JTPF/003/2009) was adopted.

2. FINAL JTPF REPORT: NEXT STEPS. (DOC.JTPF/002/REV 3/2009/EN)

The Chair explained that the point was an information item only as the report was adopted under written procedure on 20th March. He thanked the Swedish delegate for her constructive comments on the EU transfer pricing triangular cases discussions. He mentioned that the recommendation on the scope of the Arbitration Convention (AC) as regards Thin capitalization and whether the adjustments on the capital amounts of the loan are covered by the AC provisions, attracted 9 reservations. Both vice-Chairs made a statement.

Stefaan DeBaets said that the recommendation is a step forward as it crystallises differing interpretations of the application of the A/C to thin capitalization. He was particularly keen to have the Business member's opinion on the final drafting.

Theo Keijzer expressed his disappointment on the reservations that he considered as incorrect and misleading: 1) Art. 1 & 4 of the AC states that the AC applies to profits that must be in line with the arm's length principle. Interest rates are function of the level of risk and debt/capital. 2) At OECD level two reports (one of 1987 and

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one of 2004) on this topic exist.(OECD comment: The OECD position on these issues is found in the report "Thin capitalization" that was adopted by the OECD Council on 26 November 1986, commonly referred to as "the 1987 Report". There are some internal discussion papers of Working Party No. 6 of the OECD Committee on Fiscal Affairs that date back to 2004; those however were never finalized and accordingly were not publicly released.) 3) In the Test Claimants case the ECJ mentioned that proper capitalization is part of the arm's length test. 4) He referred to OECD Committee on Fiscal Affairs' report on paragraph 1 of Art. 9 of the OECD model tax convention and quoted in the commentary on Art. 9: *the Article is relevant not only in determining whether the rate of interest provided for in a loan contract is an arm's length rate but also whether a prima facie loan can be regarded as a loan or should be regarded as some other kind of payment, in particular a contribution to equity capital.* 5) For all these reasons Member States not giving access to the AC will be forced to do so by national Courts. He concluded by mentioning that the Business members accepted the reservations but fully disagreed with them: capital amount is a critical part of the Arm's length test and thus covered by the AC provisions.

The Chair concluded that the recommendation and the reservations must be seen as the description of the current state of play on that particular issue and as such is useful.

The Secretariat explained that the adopted report will be put in Annex of the Commission Communication that will also include a revised Code of Conduct on the AC with the reservations. The Communication is expected to be adopted by the Commission by the end of June. Then it will be transmitted to the Council who will examine the revised Code of Conduct and Member States can make or withdraw reservations at that stage.

The Chair concluded that this report will lead to important improvements of the Arbitration Convention. However the AC is an ongoing topic where further discussions and improvements will be necessary. He also mentioned that the AC required sufficient administrative resources and he invited the tax administrations to dedicate sufficient staff to AC cases.

3. DISCUSSION ON THE SUB-GROUP REPORT ON NON-EU TRANSFER PRICING TRIANGULAR CASES.

The Chair invited Stefaan DeBaets to make a presentation of the discussions of the sub-group.

Stefaan DeBaets explained that the sub-group made progress and that his presentation will describe non prescriptive possibilities to deal with non-EU TP triangular cases. The document is a sub group discussion document only and has no official status. Also at times the remit of the sub group seemed to not cover some subjects raised in discussion and additionally the sub-group could not find a consensus on those topics. However, having had the discussion it was felt appropriate to present them orally. The document is divided in three parts:1) a preamble aiming to reflect the sub-group agreement not to make reference to any legal analysis of the AC provisions as regards the scope and the arm's length principle 2) the definition 3) sub-group suggested approaches to deal with those cases. The oral issues he raised were: 1) elimination of the double taxation and the

arm's length principle: they should be dealt together but should one prevail on the other one? 2) would it be helpful to invite Member States to provide information (a list) whether their tax treaties include art. 25.3 and what are their intention as regards art. 25.5.

The Chair invited the members to make comments and to inform the Forum about their expectations on this topic.

One business member reacted by recognizing that the presentation was fairly correct but pointed out that the Business members are not satisfied by some drafting elements of the document. They disagreed with the sentence in the second paragraph of the preamble: it is not an option to apply the AC even when third parties are involved. The JTPF should not give this kind of signal. This sentence should be deleted. Another problem with the document is that it does not include a paragraph suggested by business: *It is a reasonable proposition that where there is a transaction involving a non EU third State, EU taxpayers should – as far as possible – enjoy the same certainty of elimination of double tax or protection against double tax as transactions involving only EU Member States. On the other hand, the protection offered should not exceed that level.*

The Chair explained that the second paragraph is linked to the sub-group agreement not to make reference to any legal aspect.

One tax administration member said that she disagreed with the Business legal analysis: once the problem of double tax is clearly identified as coming from a third non EU country the AC is not applicable. However to avoid this polemic and issues out of the sub group remit the sub-group decided not to make reference at all to legal aspects and this is captured in the second paragraph.

Long discussions took place from which it should be retained:

1) in a non EU TP triangular cases two kind of transactions can be identified: one between EU Member States and one between EU MS and a third country.

2) the business position is that the double tax must be eliminated firstly between the EU Member States and then the case will be referred to the third state for a secondary adjustment

3) the Member State position was to start by resolving the case with the third country and then to apply the AC. This position is also influenced by the existence of timing issues

4) the business fear is that the application of the AC will generally be denied because in most transfer pricing cases a third party is involved.

5) the agreed definition was drafted as a safeguard to avoid a systematic non application of the AC

6) in a case fulfilling the criteria as set out in the definition the advisory commission would also conclude that the double tax problem is not within the EU

7) it was underlined that this triangular problem is not limited to the application of the AC provisions but it could also take place once applying art. 25.5.

The Chair concluded that the JTPF is happy with the second part of the document where dispute resolutions possibilities are suggested. And this outcome is very interesting. However the problem to be solved is the preamble and the reference to what certainty a taxpayer can expect in those cases. He invited the Secretariat to revise the preamble by combining the two paragraphs that will then be sent for comments.

4. DISCUSSION PAPER ON CENTRALIZED INTRA-GROUP SERVICES ((REFERENCE DOCUMENTS:

Doc.JTPF/001/2008/EN New document: Draft summary table on the questionnaire on shareholder activities (doc. JTPF/004/BACK/2009/EN)

(reference documents already available for the last meeting: doc. JTPF/014/REV2/BACK/2007/EN , doc. JTPF/022/BACK/2007/EN , doc. JTPF/012/BACK/2008/EN, Secretariat working document prepared for the tax administration sub-group meeting doc.JTPF/021/2008/EN, summary record of the Malta sub-group meeting doc. JTPF/022/BACK/2008/EN, Business contribution on costs allocation doc. JTPF/023/BACK/2008/EN, Prof. Maisto draft report on shareholder costs doc. JTPF/024/BACK/2008/EN – in Pdf format, doc. JTPF/025/2008/EN)

The Chair reminded that the Secretariat prepared a document for the November meeting where a 6 stages approach is described. During our last meeting we reached agreement on two conclusions on stage 1 that will form part of the future report. The present meeting aims to discuss stage 2 on shareholder costs based on the report that has been drawn up by Prof Maisto (with the support of other tax practitioners).Considering that in national law, administrative procedures and case law there are not many definitions or information the question arose :"what are the shareholder costs?" The Secretariat sent out a questionnaire on 5 December. A number of replies have been received that are compiled in the summary table. The Forum was invited to examine the questionnaire with the replies and look at what common understanding can be agreed.

As regards the Dutch comments in the table it was clarified that the reference to Document IFZ 2004-608 was a Dutch Decree. An English version will be made available to all members.

The Chair before examining the document point by point stated that a number of members mentioned that any list should be indicative, and neither prescriptive nor restricted. One member objected on the grounds that the list should be drawn up by the OECD. The Chair replied that this topic is clearly within our mandate and was put on the work programme. The list provides examples to facilitate the work of administrations and shareholders. In the table the wording in Italics is the actual OECD text.

Questions a, a1 and a2: general agreement that those costs are considered as shareholder costs.

Question a4:

Prof Maisto mentioned that regarding the costs of a Board of Directors, the OECD makes the distinction of the costs of Director fees paid as a result of basic functions as a Director and any other costs related to a different function performed by the Board member.

Several other business members explained their own daily practise which led the Chair to conclude the necessity of understanding the context of a particular cost and not to make general assumptions. The Chair said that in examining this cost it should be borne in mind that there are potentially two hats. The fact that the member of board will carry out his task beyond his statutory duties will raise the following questions: is it benefitting the whole group, does it benefit the parent company, should it be allocated out to the subsidiaries, or should it be considered to benefit a certain subsidiary? He concluded that from the various contributions it can be concluded that a case by case approach is always appropriate: part of the costs of the board fall to the parent company and some to the subsidiaries. How is this divided? It depends on the type of industry, the type of company. In the revised drafting the Secretariat will make sure that those considerations are reflected.

Question a5: agreed.

Questions b and b1: agreed.

Question b2: Consolidation of financial statement of the group.

A discussion about what costs are covered took place: all costs that are necessary for consolidation at what ever level. It might be for the parent company or the subsidiary and the question is who benefits. There might be a parallel benefit for the subsidiaries but consolidation is the activity of the group as such. Some members explained that in practise local costs for the subsidiaries are not passed on to the parent because it would be too costly to identify and to isolate those costs.

Question b3: Costs for application and compliance with cross-border tax consolidation

After a short exchange of views it was concluded that in almost all cases it is only the parents that benefit from that costs. The questions to bear in mind when examining them are who pays for it? And who the beneficiary is really?

Question b4: Costs for the audit of the parent company.

Everybody agreed that this is a shareholder cost.

Question c: Costs of raising funds for the acquisition of the parent companies participations

Everybody could agree that it is a shareholder cost but one tax administration suggested that instead of being a shareholder cost it could be an operational cost of the parent. Business Member invited further clarification from that member. The following clarification was provided *"these costs are shareholders costs as far as the funds raised are equity capital (and not debt capital). In case debt capital is raised those costs would rather qualify as financing expenses which are not included in the operational profit (and not "operational costs")".*

Question d: Cost of managerial and control activities linked to investments in participations

It was agreed that monitoring and controlling activities at large are shareholder costs. However it should always be checked whether through certain activities there have been benefits for the subsidiary (and in that case some part could be allocated to it).

Question d1 Costs of the parent company audit of accounts of the subsidiary, if carried out exclusively in the interest of the parent company

It was considered that the drafting was sufficiently clear but duplication of cost needed to be guarded against

Question d2 Costs for the drafting and auditing of the financial statements of the subsidiary in accordance with accounting principles

It was agreed that those costs are to be considered as shareholder costs. However some practitioners have mentioned that in practise most of the work is probably done at the level of the subsidiary and it is very time consuming to evaluate how much should be charged out and therefore the cost is generally kept in the subsidiary.

Question d3 IT costs for the monitoring by the parent

The way the question is drafted (incurred exclusively for the monitoring by the parent) leads to the automatic conclusion that it's a shareholder cost. However practitioners have mentioned that IT costs are rarely exclusively for the benefit of the parent. The chair concluded that costs which are not exclusively undertaken for the parent company but also to serve and advise the subsidiary in its own management will request an allocation key. So again a case by case approach is necessary.

Question d4 cost for the review of affiliates

The Chair concluded in the same way as for question d3: that costs can be performed are exclusively for the parent and are in that case only shareholder costs however in many cases this can help to improve the subsidiary's management as well and will request an allocation key.

Question e cost to reorganize the group, to acquire new members or to terminate a division

It was noted that recent developments in the economy were such that conglomerates are no more focused on increasing the size of the whole group but acquisitions or investments are rather focused on the benefit of particular sectors of the group. The Chair concluded that this type of cost is indeed undertaken to the benefit of the subsidiary rather than to the benefit of the entire group. He also drew the attention to the OECD discussions on business restructuring where the discussion about cost undertaken for restructuring purposes leads to questions as to the entity that should be bearing the expense.

A Business Member observed in his corporate structure general acquisitions and demergers are generally attributed to a particular division not as a parent only acquisition.

The OECD observer commented that OECD views are not to treat restructuring costs such as write off of assets, termination of employment contracts, etc. as shareholder costs or as a service, but rather to examine on a case-by-case basis which entity should bear these costs, depending in particular of the rights and other assets of the parties. There is some discussion in the OECD discussion draft on the transfer pricing aspects of business restructurings about which entity within an MNE group should bear the restructuring costs and the OECD tentatively concludes that depending on the facts and circumstances of the case, it could be the restructured entity, another group entity that benefits from a relocation of activity, the parent company, several group entities. OECD observer emphasises that costs for analysing the question of whether or not to restructure was an appropriate shareholder cost.

The Chair concluded that again this suggests a case-by-case approach. Sometimes it is the restructured entity that should bear the cost because it is also receiving the benefit, or sometimes it is another entity of the group that should bear the cost. Part of the problem in business restructuring is also of course when we have a sub-contracting of activities or removal activities from the premises to moving them somewhere where things are cheaper. This may require a re-drafting of Point E

Question f: cost for initial listing on a stock exchange

No specific comments here: this is a shareholder cost.

Question g: investor relations

No comments it's a shareholder cost

Questions h and I: study and implementation of the capitalization structure of the subsidiaries

At the request of the OECD both questions were discussed together. Different views were expressed and it was agreed to adopt a case-by-case approach because it may well serve the subsidiary, but could also be useful to the parent company in order to optimise their resources.

Other activities identified as shareholder activities.

A reply from Baker & McKenzie referring to activities relating to the adoption and enforcement of statutory rules and rules of conduct with regard to corporate governance by the parent company itself or the group as a whole.

This is the implementation of rules of governance by the parent company and it was agreed it should be considered as shareholder costs.

On stage 2 the Chair concluded that a revised table will be prepared by the Secretariat and that will become an annex of the future report.

Stage 3 of Secretariat document

Chair explained that this stage aimed to develop an approach on low value added services: what are the problems, what does the JTPF expect? He invited Stefaan De Baets to explain the tax administrations conclusions reached in the pre-meeting.

The tax administration vice-chair explained that the tax administrations discussed about this topic during the sub-group meeting in Malta and during the pre-meeting on the basis of replies he collected on his questionnaire aiming to collect tax administrations views on whether they have problems with 'routine services', whether it is resource demanding, how many cases are dealt through MAP. From the discussions held in the pre-meeting it seems that such 'routine services' were generally no longer perceived to be a problem. The consensus was that some difficulty can arise on identifying the provision of a service and standards of evidence in relation to costs but generally problems could be resolved pragmatically.

Chair concluded that the Secretariat prepared several papers based on the Member States original contention that routine services were a problem. Therefore now the group needs to identify how to develop further the document.

The Business vice-Chair said that for him the main merit of stage 3 was to use it as a learning exercise before examining more complex services. The Business members have already prepared examples of more complex services provision that can be used to facilitate the future discussions.

The concern expressed by a majority of tax administrations was about evidence and documentation problem that should facilitate a better understanding of the costs incurred. Direct costs, indirect costs and allocation keys were also recognised as important topics. Tax administrations said that before going further it would be important to agree on what documents can be provided to help them to understand the services provided

The Chair concluded that the pricing and the cost do not seem to be an issue but evidence and documentation. However it should not be forgotten that the JTPF has always taken the approach not to put a too burdensome level of requirements on taxpayers. What seems missing is a comprehension of an intra group central service provision to elucidate the reasoning before costs are allocated. He suggested that after this meeting it an orientation discussion will be needed to determine the way forward.

5. DRAFT 2008 APA TABLE ON THE AVAILABILITY OF AN APA PROCEDURE (DOC. 020/REV1/2008/EN)

France and Luxembourg have still to reply.

A new questionnaire will be issued to collect the figures at the end of 2008.

6. ANY OTHER BUSINESS:

6.1 EUTPD questionnaires:

As regards the questionnaire on the implementation of the Code of Conduct on transfer pricing documentation sent to all Member States, the following MS have not yet replied: Austria, Finland, Italy, Ireland, Lithuania, The Netherlands, and Portugal.

BusinessEurope will also send out a questionnaire to its members on the practical documentation problems and prof. Maisto will conduct a study on documentation requirements in Europe.

6.2 next meetings: **3rd June and 27 October**