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EU JOINT TRANSFER PRICING FORUM

CONTRIBUTION BY THE BUSINESS MEMBERS OF THE EU JOINT TRANSFER PRICING FORUM:

REVIEW OF SOME OUTSTANDING ISSUES IN CONNECTION WITH THE DISPUTE RESOLUTION PROCEDURE

Meeting of Thursday 11 December 2003

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Background document

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REVIEW OF SOME OUTSTANDING ISSUES IN CONNECTION WITH THE DISPUTE RESOLUTION PROCEDURE

1. INTRODUCTION

1.1 Now that the EU Joint Transfer Pricing Forum (JTPF) is close to end discussions on the interpretation of the Arbitration Convention (AC), the Business Members of the JTPF want to address once again their concern about a number of issues, some of which have been dealt with during our debates while some others have not. We are aware of the fact that all of them are items which are very related to local law matters and national legal traditions and that, therefore, seems very awkward to come to an agreement at this stage of our works or to go further than the point reached in some cases.

1.2 However, all of them can also generate or intensify the economic burden of double taxation in the transfer pricing arena within the EU and, therefore, without any further development on those items, now or in the future, the aim inspiring the creation of the JTPF will not be culminated. In this sense, the AC provides for the avoidance of double taxation. Arguably, this goal can be construed to cover the avoidance of the additional economic burden arising from any transfer pricing reassessment.

1.3 Those issues are the following:

- Suspension of tax collection during cross - border transfer pricing dispute resolutions.
- Interest charges for late tax payments.
- Penalties levied on such tax adjustments.

1.4 In short, the Business Members want to welcome the results achieved by the JTPF in connection with the interpretation of the AC and some of these related matters but also want to remind the European Commission and the Council of the importance of taking further action and give a reasonable solution to all of them so that businesses do not undergo international (rather, intra – Community) economic double taxation arising from the variety of different laws and practices of the Member States when making transfer pricing reassessments. Otherwise the Single Market will not become a complete reality in this field, in spite of the commitments undertaken by the Member States in the Treaty of the European Communities (EC Treaty).

2. SUSPENSION OF TAX COLLECTIONS DURING CROSS – BORDER DISPUTE RESOLUTIONS

2.1 The aim of the AC is to grant taxpayers with a quick dispute resolution procedure, subject to the withdrawal of any domestic appeals lodged by the taxpayer with the national judicial courts. In this context, as we already highlighted in our paper of 28 April, 2003, it does seem reasonable to grant the taxpayer, at least, with the same suspension rights as those provided

for in the national legislation when a domestic appeal is lodged with administrative or judicial courts, in case the latter would rather file an application for a mutual agreement procedure under the AC or under any given tax treaty between two Member States. Otherwise, the application of the AC will be minimal.

2.2 Moreover, the above seems to be simply a first step now that the EU is becoming a community of citizens guaranteed by a Constitution: taking into account that the tax was already paid to a Member State by the time when the transfer pricing reassessment is made and that any final agreement in the course of the above procedure is a zero sum game from a consolidated point of view, it is difficult to accept that a company should advance (again) the money of the reassessment before the case is finally decided.

We actually believe that the suspension should be granted automatically if a mutual agreement procedure is initiated under the AC or the corresponding bilateral tax treaty, even if such a suspension is not possible under national legislation for domestic appeals, because although apparently the reassessment has to do with a confrontation between a taxpayer and a tax administration, in reality it is a controversy between the tax administrations of two Member States of the EU which should not be at the expense of their taxpayers.

2.3 That is why the Business Members welcome at least the introduction of a "de minimis" recommendation in the "Draft of the Code of Conduct" (see point 5 thereof) whereby

"Member States should take all necessary measures to ensure that the suspension of tax collection during cross border dispute resolution procedures (under the Arbitration Convention and Double Tax Treaties between member States) can be obtained by enterprises engaged in such procedure, under the same conditions as those engaged in a domestic appeals/litigation procedure".

If any, we would suggest at this stage that this recommendation is enhanced by the inclusion of a reasonable deadline, for example 2 years since the date when the AC enters into force.

3. INTEREST CHARGES FOR LATE TAX PAYMENT

3.1 Each Member State claims the right to fix the interest rate for late payments of tax at its own discretion. Therefore, it is possible that interest rates for tax payments will differ widely between one Member State and another. These differences are especially highlighted when a bilateral adjustment takes place: to what extent should the tax administration accepting a bilateral adjustment originating in a transfer pricing reassessment made by another Member State cover the interests for late payment laid down by the legislation of the latter?

3.2 As the Business Members highlighted in our paper of 28 April 2003, the use of the AC procedure by the taxpayers could be fostered if the Member States accepted in their domestic laws that the accrual of interest for late payment be suspended while the mutual agreement and arbitration procedures are in place. Again, this decision could not be considered as discriminatory (as opposed to what happens if the taxpayer opted for an internal judicial appeal), but reasonable, since the AC procedure entails a negotiation between two administrations, rather than a confrontation between the opinion 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, additionally, 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 item for discussion (consisting of the extent of the bilateral adjustment to be applied by the Member State accepting it).

3.3 Alternatively, Member States should consider harmonizing the interest for late payment rate in the EC taking into account that the majority of those are now members of the Euro – zone and on the basis that interest charges should simply reward the use of money and not be used as a hidden penalty charge. Not only the rate, but also the question of deductibility or taxation if interest is received, should be a matter of harmonization, to avoid double taxation or non – taxation of said item.

If this alternative solution was eventually implemented, either the competent authorities (under the mutual agreement procedure) or the advisory committee (under Art. 7 of the AC) should have the right/obligation to decide finally about equalization of interest and their deductibility taking into account both Member States' statements.

4. PENALTIES LEVIED ON TRANSFER PRICING ADJUSTMENTS

4.1 Art. 8.1 of the AC provides that the competent authority of a Member State will not be obligated to follow its procedure if a serious penalty (as set out in the Annex to the AC) is imposed to the taxpayer in the course of a transfer pricing reassessment.

4.2 Having a look at the corresponding Annex of the AC containing the list of serious penalties applicable in each Member State, a neutral reader can easily have the impression that the applicability of the AC lies in fact in the hands of the tax administration making the transfer pricing reassessment, given that serious penalties can be laid down in many countries simply if a specified threshold is exceeded.

Merely because the threshold has not been amended since 1990, it is very low, especially from the point of view of transfer pricing adjustments. This is already a good reason to amend it. Another good reason is that the laws of many Member States governing the imposition of penalties have changed since then or are about to change.

4.3 But further to that, it does not seem to be fair that the applicability of the AC is so much in the hands of one of the parties: it is doubtful whether this list of domestic penalties (and its potential application by the national tax administrations) is in line with Article 27 of the Convention of Vienna on the interpretation and application of the international treaties (any party to a treaty shall not be able to invoke its domestic provisions to justify the non – compliance with the treaty).

4.4 On the other hand, the Business Members of the JTPF want to refer as well to the application by a number of Member States of automatic penalties provided for by their national legislation if a certain percentage or amount of income adjustment is made by their tax authorities. Even if those penalties do not impede the use of the AC (because they are not envisaged in the Annex to the Convention), this is generally viewed by businesses as excessive, given the fact that transfer pricing is not an exact science and there will always be room for differing views.

4.5 Moreover, it is doubtful that it allows for a correct application of the principle of loyalty set out by Art. 10 of the EC Treaty: we cannot forget that when a taxpayer initiates this mutual agreement procedure and/or arbitration procedure, one out of the two Member States involved are of the opinion that the reassessment is not justified. Laying down a penalty to the taxpayer could then be construed as meaning that the other Member State has collaborated in the infraction, something which is not acceptable: in fact, we believe that this is a suitable argument for a taxpayer to put forward before a judge when reviewing the validity of penalties laid down by a given tax administration in a transfer pricing audit. In short, objective penalties do not seem to suit with the reality of the transfer pricing world, especially within the Single Market.

4.6 Therefore, the Business Members suggest that

- On the one hand, the Member States review and amend the list of serious penalties to apply in cross-border transfer pricing reassessments. In our view, the amendment should be based on our conviction that serious penalties in this field should be imposed only in cases of gross negligence or willful misconduct by the taxpayer, rather than simply when a given threshold is exceeded. No such behaviour would be deemed to exist if the taxpayer did follow the documentation requirements applicable from time to time or if the tax administrations of the Member States involved decided to start a mutual agreement procedure under the AC or the corresponding bilateral tax treaty, because any of both facts clearly points out the diligence of the taxpayer's behaviour.

- On the other, as far as automatic penalties (not impeding the access to the AC) imposed in the course of transfer pricing audits dealing with intra - Community transactions are concerned, either the competent authorities (under the mutual agreement procedure) or the advisory committee (under Art. 7 of the AC) should have the right/obligation to decide finally about them taking into account both Member States' statements.

In our view, this would be the way to secure better the right of the taxpayers to the use of the AC provisions as well as the way to better implement the principles arising from the creation of the Single Market.

Eduardo Gracia and Ulrich Moebus, on behalf of all the Business Members of the JTPF
6 November 2003