EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Direct taxation, Tax Coordination, Economic Analysis and Evaluation
Company Taxation Initiatives

Brussels, January 2013
Taxud/D1/

DOC: JTPF/002/2013/EN

EU JOINT TRANSFER PRICING FORUM

Discussion paper on ways to improve the functioning of the Arbitration Convention

Meeting of 14 February 2013

Contact:
Jean-Marc Van Leeuw, Telephone (32-2) 29.58.936
Hartmut Förster, Telephone (32-2) 29.55.511
E-mail: taxud-joint-transfer-pricing-forum@ec.europa.eu

A. Background

The 2011-2015 JTPF Work Programme states that monitoring of previous achievements will be conducted with the aim of establishing to what extent the previous work of the JTPF is implemented, to evaluate its effectiveness and to consider how improvements might be made.

As monitoring the Arbitration Convention (AC)[1] and its related Code of Conduct (CoC)[2] was already identified as a major point of interest at the June meeting, the Chair invited JTPF Members to send any suggestion/proposal for further improvement of the AC and the CoC to the Secretariat by 15 July 2012. The responses received can be found in document JTPF/020/REV1/2012/EN.

In the JTPF meeting on 25 October 2012 a paper called "Monitoring Overview and Proposals" was discussed and the JTPF formally agreed to start to monitor the Arbitration Convention and its related Code of Conduct in 2013.

MS agreed on doing a qualitative analysis of their pending cases to find out the concrete reasons why cases have lasted more than 2 years. The responses are summarized in document JTPF/003/2013/EN

For reasons of transparency and fairness, this paper quotes all the suggestions received (in *'italics'*) without clarification amendments and introduces items for discussion. It is intended to have a first discussion in this meeting and find out JTPF Members' views on which of the suggestions further work should be done.

B. Problems encountered/Room for improvement

1. Exclusion of access to the AC based on different arguments

PSM and MS reported the following instances where access to the AC was denied:

1.1 '*The tax adjustment proposed regards de facto a transfer pricing issue but is being presented as an adjustment based on a general anti-avoidance provision and as such deemed excluded from the AC, i.e. thin cap argumentation*[3] *or lack of substance argumentation as regards recipient of intercompany fees for services, IP etc*;'

[1] Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/463/EEC)

[2] The initial Code of conduct conduct for the effective implementation of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (2009/C 322/01) was adopted in 2006 and a revised Code of Conduct (CoC) in 2009.

[3] Secretariat's comment: see reservations relating to point 1.2 CoC

1.2 '*The tax adjustment is presented as regarding the determination of the existence of a permanent establishment rather than the allocation of income to a branch/permanent establishment and as such deemed excluded from the AC.*'

1.3 '*The tax adjustment is seen as not creating double taxation and as such held to be excluded from the AC, after which the CA does not proceed with informing the CA of the other Contracting State.'*

1.4 '*Business restructuring-related matters between related parties are often referenced as not being transfer pricing matters and as such not eligible for relief under the AC, even though the OECD clearly considers them as such and they regard the allocation of a buy-out and restructuring related costs between related parties*[4].

For discussion

The problems reported in these examples seem to result from different legal interpretation in specific cases between TAs and/or taxpayers.

1. Do you think further guidance or clarification can be developed on some of these issues (Article 5 OECD Model Tax Convention (MTC), meaning of double taxation, meaning of transfer pricing) in the CoC?

With respect to time limits, Best Practice No. 9 of the OECD MEMAP advocates for a flexible approach giving the taxpayer the benefit of doubt in borderline cases.

2. Do you think such a recommendation with respect to time limits is appropriate?

Point 6.3 (f) CoC states that if the competent authority does not believe that profits of an enterprise are included, or are likely to be included, in the profits of an enterprise of another Contracting State, it will inform the enterprise of its doubts and invite it to make further comments

3. JTPF members are invited to report on how this recommendation is followed in practice?

Point 1.2 CoC refers to thin capitalization issues as being part of the scope of the AC but several MS made a reservation.

4. TAs are invited to review their reservation and inform the Secretariat whether it is still valid[5]**.**

[4] Chapter 9 of the 2010 OECD TPGL

[5] It should be noted that the Netherlands already informed the JTPF in October 2010 that their reservation was no longer valid.

1.5 '*Triangular cases are either excluded from the AC or if allowed in, they do not have access to one of the key items: the arbitration phase.*'

For discussion

During the previous discussions JTPF members concluded that the recommendations on triangular cases should be reviewed based on practical experience to be acquired.

1. Therefore, TAs and PSM are invited to inform the Secretariat of their practical experience with this issue since the CoC has been adopted.

2. Are there different experiences in EU and Non EU triangular cases?

3. If you see room for improvement, should these issues be discussed in the context of this project or under a separate topic, i.e. in the context of a separate monitoring of EU- and Non-EU triangular cases[6]?

1.6 PSM state that '*Issue of taxation on "deemed" income resulting from the corresponding adjustment such as interest income or withholding tax. The inclusion of resolution of (double or additional) taxation resulting from secondary adjustments is often not considered or not addressed, even though it constitutes taxation on income.*'

For discussion

In the Questionnaire on secondary adjustments most MS stressed that they do not regard secondary adjustments as falling under the AC. The issue of secondary adjustments has been addressed in the JTPF report on secondary adjustments (JTPF/017/FINAL/2012/EN). Therefore no further discussion seems to be needed.

1.7 PSM state that '*Cases continue where interest and penalty relief are not considered part of the MAP/arbitration phase. As to interest, the way it is dealt with by the respective countries often does not match. As example, whereas interest on underpayment of tax in one State may remain, it is far from always compensated by interest on the "overpayment" in the other State. Furthermore, where interest on an "overpayment" is usually taxable itself as income, late payment interest is often not a deductible expense.*'

For discussion:

The issue of interest was addressed in the previous report by including a recommendation in point 8 (b) CoC.

[6] See section IV 2 of the Monitoring overview (JTPF/018/2012/EN)

1. JTPF members are invited to inform the Secretariat about how this recommendation has been implemented in practice.

2. Do JTPF members think that this topic requests any further work?

1.8 PSM state that '*there is uncertainty on how to deal with corresponding adjustments (after year-end) and if the MAP solution is to be implemented going forward, uncertainty how to deal with compensating adjustments (or implementation of the MAP solution to later years with similar facts, for that matter). Further, adjustments that are submitted to MAP relating to one year (and that get resolved) nevertheless get raised again and again in later years by the tax authorities of the country that made the primary adjustment. This seems like a "double jeopardy" situation. Is it possible to apply a MAP resolution to later years if the same facts apply.*'

For discussion:

The issue of compensating adjustments is addressed in a separate project of the JTPFs program of work.

1. Should a simplified MAP be applied for adjustments or assessments of transactions in the period after the years covered by the initial MAP/adjustment where the facts are similar to the ones being subject to the initial MAP?

2. Should issues already covered by a MAP in future periods be regarded as low risk areas for purposes of risk management, provided the facts and circumstances stay the same?

1.9 PSM submitted an additional contribution in January by providing examples on situations where in practice the Arbitration Convention cannot be accessed or does not result in fully removing double taxation[7]. The problems encountered in these examples result from the interaction between Article 7 and 5 of the OECD MTC, between MAP and juridical appeals and the correlation to certain penalty regimes

For discussion:

The issues described in the examples are on a separate basis addressed in the previous sections. The value of the examples is the description of the interaction between these issues.

[7] See JTPF/020/REV1/2012/EN

It is suggested to address the problems of interaction at a later stage, i.e. after a preliminary conclusion on the separate issues.

2. Improving the functioning of the AC in general

2.1 It is also suggested to improve the functioning of the AC '*by developing a practical manual for taxpayers in the EU with links to documents and minimum requirements needed*.' In this context, the JTPF could prepare a document including a list of contact points for CAs (similar to the list on the OECD website)[8] that would be regularly updated.

For discussion

1. Do you regard such a manual with practical information as useful?

2. If so, which information not already part of the CoC should it contain?

3. Do you regard developing a list of contact points as useful? (If yes: For MS who are also OECD Members, the information from the OECD website could be taken and Non OECD MS would be asked to provide this data).

2.2 PSM raised the question *'whether Article 5 of the AC (a MS which intends to make a profit adjustment shall inform the enterprise of the intended action to give it the opportunity to inform the other MS) is actually used in practice*.'

For discussion

Early notification might be a way to draw the attention of the other TA to the fact that a MAP might be addressed in the future and therefore particular attention to the collection and storing of related documentation should be given.

1. Do you have practical experience with this provision or with what is stated in Best Practice No 8 of the MEMAP?

2. Do you regard this kind of information as useful and if so, how could its use be improved?

2.3 PSM stress that *'there are instances where Contracting States consider a case not yet "ripe" for CA review and the 3-year term not yet commenced because no actual tax adjustment is made, contrary to the explicit language of the AC:*

[8] http://www.oecd.org/document/31/0,3746,en_2649_37989739_29601439_1_1_1_1,00.htm

"This Convention shall apply where, for the purposes of taxation, profits which are included in the profits of an enterprise of a Contracting State are also included or are also likely to be included in the profits of an enterprise of another Contracting State…".[9]

For discussion

1. How do TAs deal with requests regarding cases where double taxation is likely to arise?

2. Are these early requests considered as a way to improve the MAP under the AC?

3. What do you think could be done further?

2.4 A MS suggests recommending *'to the taxpayer to submit a request to apply the AC by e-mail (and/or by ordinary mail) to both CAs at the same time*.' This would avoid the problem that MS inform each other later than foreseen in the AC and may also result in early knowledge and discussions of a case, for which the AC is not applicable in the view of one of MS.

For discussion

1. **Do you support the view that such an approach would improve the arbitration procedure?**

2. If so, do you think a recommendation in the CoC inviting the taxpayer to put the other Contracting State in copy of a MAP request under Article 6 (1) AC should be made?

2.5 A MS suggests *promoting the use of 'multilateral MAP' in case a TA does adjustments towards more than one MS*. Another MS suggested *that an increased use of multilateral controls, may also help to reduce the risk of disputes and would improve the functioning of the AC*.

For discussion

Should more guidance on multilateral MAP approaches[10] be developed?

[9] Article 1 Paragraph 1 of the AC.

[10] Mentioned for EU triangular cases in point 6.2 (b) (i) CoC

Improving the use of multilateral controls within the EU is currently discussed as part of the JTPF work on risk management. Therefore this topic should not be addressed in the context of the monitoring the AC.

2.6 A MS asked clarification on how to deal with information that is submitted in MAP but not in an audit.

For discussion

The question here is whether a MAP should be considered as a second review The AC and the CoC[11] seem not to provide explicit guidance on the possibility of further requests from CAs for additional information during a MAP procedure and how to deal with information submitted by the taxpayer after initiation of the MAP. The MEMAP[12], however, indicates that CAs can make further requests during the procedure and that the taxpayer should have an interest in providing CAs with updated information or new information or documentation relevant to the issues under consideration.

1. Do you think that CAs have or should have the possibility to request further information after the MAP request was considered as well founded in the meaning of Article 6 and 7 AC?

2. If so, do you think this possibility or the scope for requesting further information should be limited or is limited?

3. Should the CoC also contain a recommendation that new information should/could be submitted?

4. How do you think it should be dealt with situations where a taxpayer voluntarily provides certain information at a late stage of a MAP and not at the stage of audit and there is evidence that the information could have been delivered earlier?

2.7 A MS proposed *'to recommend the taxpayer to translate in the common working language the request and all the documents containing the information requested in Article* (point) *5 (a) CoC.'* .

For discussion

[11] See points 5 (a) vi, vii, viii CoC

[12] See Best practice no 5 and par 3.3.1 of the MEMAP

Point 6.3 (a) CoC provides that in order to minimise costs and delays caused by translation, MAP and in particular the exchange of position papers should be conducted in a common working language, or in a manner having the same effect, if the CAs can reach agreement on bilateral basis.

1. Do you think more guidance on the term "common working language" could be developed?

2. Do you think appropriate to prepare a 'state of play' table including information about this issue?

2.8 One MS suggest it should be ensured '*that CAs can decide independently from field auditors.*'

For discussion

Best Practice No. 23 of the OECD MEMAP recommends that in order to enhance the independence of a subsequent review of a case by a competent authority, it is recommended that competent authorities maintain a level of autonomy from the audit function of a tax administration.

Do JTPF members think a similar recommendation should be added to the CoC?

2.9 A MS referred to the problem that arises in cases where the audit in one MS is early and in the other very late which may lead to the result that information in the State of the early audit may no longer be available.

For discussion:

A general solution in the sense of guidance seems problematic as the way audits are conducted and their timing falls into the national competence. However, the following existing measures may help to at least improve the situation:

- Early audits (as are already promoted in various OECD projects).

- Multilateral controls

- Early notification under Article 5 AC

- EOI at the stage of the audit (before the adjustment is final)

Do you think further measures can ьe taken and could be addressed in the context of improving the functioning of the AC or would this issue be better placed in the context of the JTPF project on risk management?

2.10 PSM refer to issues arising when *'very large and rather unsubstantiated tax adjustments are proposed, followed by settlement proposals under substantial pressure for a significantly lower amount, subject to the condition that no access to the MAP is available'* .

For discussion:

Best practice No. 19 of the MEMAP provides that both taxpayers and tax administrations should avoid the inclusion of a waiver of access to MAP in audit settlements. Since MAP involves bilateral issues, it is inappropriate to have two parties (the taxpayer and one tax administration) excluding the third party involved (the other tax administration) in the final resolution of a file.

Do JTPF members think such a statement should be added to the CoC?

2.11 PSM reported difficulties *in getting access to extension of payment for adjustments when filing for AC-based MAP relief.* According to the understanding of the Secretariat it is referring to the issue of tax collection that should be suspended during the MAP.

For discussion:

Point 8 CoC contains a recommendation basically saying that tax collection should be suspended during the MAP procedure.

Best practice No 21 of the OECD MEMAP states that "*the collection of tax as a condition to entering a program to relieve that very tax is generally considered to be unreasonable. Thus, it is a best practice and goal for tax administrations to provide a procedure for suspension or deferral of the requirement to pay a tax liability (including interest thereon) or the collection action of a tax administration on income tax that is the subject of the request for competent authority assistance. The decision to suspend or defer collection could be made after a risk assessment has been conducted by the tax administration to determine ability to pay or the creditworthiness of the taxpayer. The suspension/deferral could begin at the time of application and remain in place until the resolution of the case by the competent authorities. In some countries suspension or deferral of collection actions is not possible due to various reasons beyond a policy determination. In these cases, the acceptance of security in lieu of payment during competent authority proceedings may be an opportunity to lessen the effect of double taxation*"

1. TAs are invited to inform the Secretariat by 27th of March about how point 8 CoC was implemented.

2. Based on the information received, the Forum should assess to what extend this recommendation should be amended.

2.12 PSM report that '*Confidentiality of taxpayer information is not fully assured, in the sense that (MAP) settlements on issues appear to be communicated to other tax authorities where the taxpayer has operations and where no adjustment was raised.*'

For discussion:

Article 9.6 of the AC and point 6.3 (c) of the CoC state that confidentiality of information will be ensured.

Do JTPF members think that more should be done?

2.13 Poor information to taxpayer during the MAP process: *There is a clear need for better information to taxpayers that the AC MAP request that was filed is received by the CA and that it qualifies for handling under the AC. Currently taxpayers are in limbo when they file a MAP request as to whether the request will be considered received and qualify for purposes of the AC.* Further it is stated that *'if the taxpayer does not assert the 2-year term as expired, no mention is made thereof whatsoever and no action is taken'*

For discussion:

Point 6.3 (b), (f) and (g) CoC state that taxpayers will be informed about all developments, whether the case is considered as being well founded and whether it the request is made within the time limits foreseen under the AC and about the starting point of the two year period.

TAs are invited to provide information to the Secretariat on how 6.3 (b) is applied in practice.

Do JTPF members think more can be done?

3. The 2 year period under Article 7 AC

3.1 PSM and MS encountered problems with respect to the question when the 2 year period under Article 7 AC starts. As a main problem instances where reported by PSM where tax authorities, long time after the MAP request has been filed under the AC, maintain that they did not receive sufficient information to have the 2-year term commence. A MS suggested that a manual could be developed which describes the minimum information needed.

For discussion

MS responses why cases take longer than 2 years show that often the reasons for a long duration is routed in legitimate reasons foreseen in the AC like pending court cases, the fact

that a final tax assessment note has not yet been issued or arbitration is still pending. Another reason reported as time consuming is the fact that specific information requested under point 5 (a) (vii) CoC is considered as not having been submitted in a sufficient manner. The starting point of the 2 year period may therefore be further delayed.

Further clarification may be given on what kind of information can be requested, whether there should be limitations to those requests, how many requests can be made and whether there are time limits that should be respected.

It should be discussed to issue new recommendations ensuring that all MS apply the same approach. It seems that points 5 (a) (vii) and (viii) CoC cause the problems.

This discussion could result in amending points 5 (a) (vii)/(viii) and 5 (b) (ii) or by providing additional guidance (or a manual as suggested by a MS) on what kind of additional information should be provided but Bearing in mind point 6.1 (e) of the CoC as relating to compliance costs. In this context we might need to better link the wording of point 5 CoC to the wording of the AC ("well founded"), i.e. make sure that the information required aims to demonstrate that the case is well founded. Further we may develop further procedure, e.g. new time limits in relation to the requirement stated in point 6.3 (e) CoC that should be respected.

1. Do you think a list of additional information could/should be developed?

2. Do you think a certain procedure for requesting specific additional information including, e.g. timelines should be developed?

3. Do you think it is already helpful if CAs exchange a template for monitoring the timelines under the AC?

3.2 PSM stressed that '*often it takes a very long time (more than 9 months) before a position paper is submitted to the other CA by the CA of the country where the primary adjustment was made.*'

For discussion

The timelines foreseen in point 6.4 (c) CoC seem clear but might need to be re-addressed based on up-to-date experience. Therefore

1. TAs are invited to inform the Secretariat whether this recommendation is followed in practice.

Point 6.1 (c) CoC states that a MNE might be invited to present its case. Is this possibility used in practice and would it be a way to provide a common understanding of the situation to both CAs?

Do you think guidance on the general form of a position paper which goes beyond of what is said in point 6.4 CoC could become a useful tool to speed up the exchange of position papers and could the guidance developed in section 3.4.1 of the MEMAP form a starting point?

3.3 PSM report, that '*in other cases, taxpayers are requested to extend the 2-year term. The request is one that often inferences that it is for the benefit of the taxpayer and the working relation it has with the tax authorities, to extend the term. However, interest cost related to the outstanding balance continues to run during the extended time during which the case is open. No duration of the extension is agreed in those instances.*'

For discussion:

Article 7 (4) AC states that CAs by mutual agreement and in agreement with the associated enterprises may waive the limits referred to in the AC and point 6.1 (d) CoC refers to it.

Do you think it would be appropriate to make an explicit statement in the CoC to avoid the problem raised by PSM?

3.4 A MS raised the question whether the MAP procedure can be finalised if a taxpayer does not provide the necessary information.

For discussion

The question is related to the issue whether during a MAP, further information can be requested by tax administrations. In case further information can only be requested to consider a case as well founded and eligible for MAP, a situation where a taxpayer does not provide requested information would result in not accepting the case under the AC.

1. In case further request can be made during the MAP, do you think tax authorities should have the possibility to mutually decide finalising MAP if necessary information is not provided by the taxpayer within reasonable time limits?

It should be noted that the AC does not include a provision explicitly allowing the finalisation of a case in such situation.

4. Second phase of the AC

The Secretariat will contact some chairmen of recent advisory commissions in order to know whether they have encountered administrative problems with the second phase of the AC. TAs are also invited to inform us about their own analysis. During the last monitoring

exercise some TAs suggested that the setting-up of a permanent secretariat might help to improve the administration of the second phase of the AC.

For discussion

1. Did TAs encounter administrative difficulties in the second phase of the AC?

2. Do TAs think that a permanent secretariat should be set in place?

5. Serious Penalties

Following the comments received from PSM '*some MS assert criminal penalties almost as a matter of course, and without the existence of a criminal act or fraud or anything of the like, as the tax police gets involved simultaneously with the tax authorities.* Further, PSM report that *some MS assert criminal penalties triggered by the amount of income tax assessed for (and not based on intent to commit) tax evasion. As a consequence these criminal penalties (triggered only by the size of the assessment) are then being seen as "serious" penalty (even though issued irrespective of intent) and will bar access to the arbitration phase of the AC.*'

For discussion:

MS are invited to update the information provided for the previous monitoring exercise about the number of cases rejected from the AC due to the existence of a serious penalties and whether their actual unilateral statement on what has to be considered as a serious penalty has been aligned with the recommendation under point 3 CoC.

6. Implications of the new Article 7 of the OECD MTC on the AC

MS suggested making a new attempt for solving the issues resulting from the implementation of a new Article 7 of the OECD MTC.

For discussion

The issue was already addressed and a paper has been prepared by the representative from Belgium (see JTPF doc 006/BACK/2011).

Do you want to address this issue and if so, at which level (e.g. in a specific sub-group)?

7. Change to "Baseball Arbitration"

Two MS suggested considering *to change the EU AC into a "Baseball Arbitration" system*"

For discussion

Article 11 (1) AC only requires that the advisory commission must base its opinion on Article 4 AC.

1. Do JTPF members consider "Baseball Arbitration" as possible and/or relevant under the AC?

8. Arbitration Convention and arbitration clauses in tax treaties

A MS suggests clarifying the relation between the EU Arbitration Convention and arbitration clauses contained in double taxation agreements (DTC). Further it was suggested to evaluate whether certain aspects of the new Article 25 (5) OECD MTC and the related Commentary may be used to improve the AC.

For discussion

MS are invited to inform the Forum about how they deal with MAP requests on TP when the DTC includes an arbitration clause. (This question was raised in the previous monitoring exercise but postponed due to the absence of such clause in any DTC between EU MS).

Which aspects of the new Article 25 (5) and the related Commentary do JTPF members consider as particularly useful for the AC?