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EU JOINT TRANSFER PRICING FORUM

DISCUSSION PAPER ON DRAFT JTPF RECOMMENDATIONS

RELATED TO THE INTERPRETATION OF SOME

PROVISIONS OF THE ARBITRATION CONVENTION

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1. Introduction

During its October 2007 meeting the JTPF recognised the need for MS to come to a common interpretation of some provisions or topics of the Arbitration Convention.

Based on the discussions the Secretariat of the JTPF was asked to prepare draft recommendations. This document is supposed to become a complement to the Code of conduct for the effective implementation of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.

2. JTPF conclusions and recommendations

This document includes some questions, statements or suggestions from the following tax administration's members: Belgium, Ireland, Italy, Slovak Rep., Sweden.

2.1 Serious penalties:

Article 8 (1) of the Arbitration Convention states :

"The competent authority of a Contracting State shall not be obliged to initiate the mutual agreement procedure or to set up the advisory commission referred to in Article 7 where legal or administrative proceedings have resulted in a final ruling that by actions giving rise to an adjustment of transfers of profits under Article 4 one of the enterprises concerned is liable to a serious penalty".

Article 8 (1) is supplemented by unilateral statements made by each MS where it is explained what is to be considered as a serious penalty.

This topic was discussed on several occasions by the JTPF and in its draft summary report on penalties (doc.JTPF/002/2007/EN) the Forum took the following conclusion:

"The Arbitration Convention currently excludes taxpayers who have incurred a serious penalty. The situation at the moment under the Arbitration Convention where 27 different definitions of a serious penalty exist does not sit easily with the idea of a single market. Therefore the JTPF will in the future look at what precisely a serious penalty should be for the purposes of the Arbitration Convention. The idea behind this work would be to clarify what a serious penalty is in terms of transfer pricing and to prevent taxpayers from being disadvantaged from different definitions within the EU. The JTPF will seek to define in which cases a penalty should be considered as serious"

In a second stage MS were invited to inform the JTPF on the number of cases where the access to the Arbitration Convention was denied. The answers were collected in a table (doc.JTPF/007/REV1/BACK/2007/EN) and from the information received it could be concluded that only two MS have denied access to the arbitration convention (twice in France and in some

occasion in Spain-but no figure is available). However the Business members expressed their concerns that this does not reflect the pressure that this AC provision can put on taxpayer to agree with the adjustment.

The JTPF recognised that several MS in their unilateral statements have described penalties that should probably never be considered as serious.

Considering that the aim of the AC is the elimination of the double taxation and that Article 8.1 provides also for a great flexibility but as the JTPF cannot change the provision of the AC, it was agreed that the Forum would recommend a liberal interpretation of the provision.

As Article 8.1 provides for a great flexibility as regards the refusal to give access to the AC due to the existence of a serious penalty and considering the practical experience acquired since 1990 the JTPF invites MS to clarify or revise their unilateral statements in Annex of the AC in order to better reflect that a serious penalty should only be applied in exceptional cases like fraud.

Slovak comments:

We fully understand the disadvantages of the current situation. In our view, it should be noted that unilateral declarations to the Arbitration Convention (AC) form the part of the AC. Therefore any recommendation made by JTPF could be useful, but on the other hand, every change or amendment should be legally binding (since the AC/Accession Convention should have been ratified by each MS). So we suppose that the recommendation of the JTPF would not be sufficient in order to solve the problem. It seems worth to consider the use of any “stronger tool”, e. g. the Council Decision to the AC, where the Member States could submit their reviewed definitions of “serious penalty”, which suit better the scope of the Article 8.1 of the AC

2.2 Scope of the Arbitration Convention:

This issue will be completed at a later stage after the completion of the thin cap questionnaire by all tax administrations.

2.3 Interest charges during MAP negotiations :

This issue will be completed at a later stage on the basis of doc.JTPF/003/2008/EN.

2.4 The setting-up of the advisory commission:

This issue is ruled by two articles of the AC:

Article 7 (1) says: *"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".

Article 9 (7) of the AC says that "*the Contracting States shall take all necessary steps to ensure that the advisory commission meets without delay once cases are referred to it*".

The Code of conduct for the effective implementation of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises provides for the following clarifications:

- Under point 4.2 "*Unless otherwise agreed between the Contracting States concerned, the Contracting State that issued the first tax assessment notice, i.e. final decision of the tax administration on the additional income, or equivalent which results, or is likely to result, in double taxation within the meaning of Article 1 of the Arbitration Convention, takes the initiative for the establishment of the advisory commission and arranges for its meetings, in agreement with the other Contracting State*".
- Under point 4.3 "*A case is considered to be referred to the advisory commission on the date when the Chairman confirms that its members have received all relevant documentation and information as specified under point 4.2 e)*".

From the above it can be concluded that no clear deadline has been established for the setting-up of an advisory commission and this can also be illustrated by the figures on the number of open cases (see doc.JTPF/005/BCK/2007). From this document it is obvious that it takes much more than three years to see a case solved where the Arbitration Convention was designed to come to a quick resolution of the disputes.

The absence of a clear deadline for the setting-up of the advisory commission is considered by the JTPF Business members as the major drawback of the AC. The JTPF came to a consensus to suggest the following recommendation:

The JTPF considers the absence of a clear deadline for the setting-up of the advisory commission as a major obstacle to a smooth functioning of the Arbitration Convention. The JTPF invites Member States to set up the advisory commission no later than 6 months following the expiration of the the period mentioned in article 7. Where one Competent Authority does not take the necessary actions the second Competent Authority shall take the initiative.

Question from the Belgian Tax Administration:

Regarding the end of the last sentence: " the second CA shall take the initiative". To do what? Initiative limited to set up the advisory commission or extended to take initiative to do all work ?

2.5 Independent persons of standing:

Article 9 says:

1. *The advisory commission referred to in Article 7 (1) shall consist of, in addition to its Chairman:*

- two representatives of each competent authority concerned; this number may be reduced to one by agreement between the competent authorities,

- an even number of independent persons of standing to be appointed by mutual agreement from the list of persons referred to in paragraph 4 or, in the absence of agreement, by the drawing of lots by the competent authorities concerned.

2. *When the independent persons of standing are appointed an alternate shall be appointed for each of them according to the rules for the appointment of the independent persons in case the independent persons are prevented from carrying out their duties.*

3. *Where lots are drawn, each of the competent authorities may object to the appointment of any particular independent person of standing in any circumstance agreed in advance between the competent authorities concerned or in one of the following situations:*

- where that person belongs to or is working on behalf of one of the tax administrations concerned,

- where that person has, or has had, a large holding in or is or has been an employee of or adviser to one or each of the associated enterprises,

- where that person does not offer a sufficient guarantee of objectivity for the settlement of the case or cases to be decided.

4. *The list of independent persons of standing shall consist of all the independent persons nominated by the Contracting States. For this purpose each Contracting State shall nominate five persons and shall inform the Secretary-General of the Council of the European Communities thereof. Such persons must be nationals of a Contracting State and resident within the territory to which this Convention applies. They must be competent and independent. The Contracting States may make alterations to the list referred to in the first subparagraph; they shall inform the Secretary-General of the Council of the European Communities thereof without delay.*

5. *The representatives and independent persons of standing appointed in accordance with paragraph 1 shall elect a Chairman from among those persons of standing on the list referred to in paragraph 4, without prejudice to the right of each competent authority concerned to object to the appointment of the person of standing thus chosen in one of the situations referred to in paragraph 3. The Chairman must possess the qualifications required for appointment to the highest judicial offices in his country or be a jurisconsult of recognized competence.*

6. *The members of the advisory commission shall keep secret all matters which they learn as a result of the proceedings. The Contracting States shall adopt appropriate provisions to penalize any breach of secrecy obligations. They shall, without delay inform the Commission of the European Communities of the measures taken. The Commission of the European Communities shall inform the other Contracting States.*

7. *The Contracting States shall take all necessary steps to ensure that the advisory commission meets without delay once cases are referred to it.*

The Code of conduct for the effective implementation of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises does not

provide additional information as regards the competency or independency requirements for the independent persons of standing.

From these provisions it can be concluded that two levels in the assessment exist: a first assessment of the independency and competency must be done by the MS before someone is put on its list and a second assessment by both States before someone is selected to become a member of an advisory commission. Moreover it should not be forgotten that the independency criteria should also be considered after the appointment of the person of standing.

The JTPF agreed that the absence of criteria to be applied for considering a person of standing to an advisory commission as independent and competent can lead to problems delaying the setting-up of an advisory commission.

Based on the experience gained by other organization in charge of (commercial) disputes resolution as regards declarations of independence and absence of conflict of interests the following recommendation is made:

The JTPF recommends using a standard notice where the selected independent arbitrators shall sign a declaration of acceptance and a statement of independence for the particular case.

Germany has withdrawn its reservation.

INDEPENDENT ARBITRATOR'S DECLARATION OF ACCEPTANCE AND STATEMENT OF INDEPENDENCE

(Please mark the relevant box or

boxes) I, the undersigned,

Name: .. First Name; _____

Preamble:

Before appointment or confirmation, a prospective arbitrator shall sign a statement of independence and disclose in writing to the Secretariat¹ any facts or circumstances which might be of such a nature as to call into question the arbitrator's independence in the eyes of the parties. The Secretariat shall provide such information to the Competent authorities in writing and fix a time limit for any comments from them. An arbitrator shall immediately disclose in writing to the Secretariat and to the Competent authorities any facts or circumstances of a similar nature which may arise during the arbitration.

¹ The Secretariat is the one set-up according to provision 4.2 C of the Code of Conduct on the AC

ACCEPTANCE

- hereby declare that I accept to serve as independent person of standing in an advisory commission ruled by the principles established in the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises as well as in the Code of Conduct related to it, in the present case. In so declaring, I confirm that I have familiarized myself with the requirements of the provisions of the Convention and I am able and available to serve as an arbitrator in accordance with all of the requirements of those provisions,

INDEPENDENCE

(If you accept to serve as arbitrator, please also check one of the two following boxes. The choice of which box to check will be determined after you have taken into account, inter alia, whether there exists any past or present relationship, direct or indirect, with any of the companies (or Multinational Enterprises) or their counsel, whether financial, professional or of another kind and whether the nature of any such relationship is such that disclosure is called for pursuant to the criteria set out below. Any doubt should be resolved in favor of disclosure.)

- I am independent of each of the *companies (or Multinational Enterprises)* and intend to remain so; to the best of my knowledge, there are no facts or circumstances, past or present, that need be disclosed because they might be of such nature as to call into question my independence in the eyes of any of the parties

OR

- I am independent of each of the *companies (or Multinational Enterprises)* and intend to remain so; however, I wish to call your attention to the following facts or circumstances which I hereafter disclose because they might be of such a nature as to call into question my independence in the eyes of any of the parties. (Use separate sheet if necessary.)

NON ACCEPTANCE

- hereby declare that I decline to serve as arbitrator in the subject case. (If you wish to state the reasons for checking this box, please do so.)

Does the Forum also want to develop specific rules that would facilitate the assessment of the competency of the independent persons of standing?

The members agreed by consensus to examine this question at a later stage: when more cases will have been sent to an advisory commission.

2.6 Date of admissibility for a case:

Article 18 says:

"This Convention shall enter into force on the first day of the third month following that in which the instrument of ratification is deposited by the last signatory State to take that step. The Convention shall apply to proceedings referred to in Article 6 (1) which are initiated after its entry into force."

During the last meeting a Business member raised the issue of the interpretation of the provisions of the AC as regards the question to know from which date a case is admissible/covered by the AC.

A consensus could be found on the following recommendation:

On the basis of article 18 of the Arbitration Convention the JTPF recommends that a case is covered by the provisions of the AC when the request is presented after the date of entry into force of the AC even if the adjustment applies to earlier fiscal years.

Agreed by consensus but Italy and Sweden have agreed subject to further examination.

Italy has withdrawn its reservation.

Swedish proposal:

We would like to propose the following wordings of the recommendation in the box: "On the basis of Article 18 of the Arbitration Convention the JTPF recommends that a case is covered by the provisions of the AC when the request is presented after the date of entry into force of the accession to the AC by the new member states, even if the adjustment applies to earlier fiscal years