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Coordination of Tax Matters

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EU JOINT TRANSFER PRICING FORUM

FUTURE WORK FOR THE JTPF

Meeting of Tuesday 21 March 2006

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Background document

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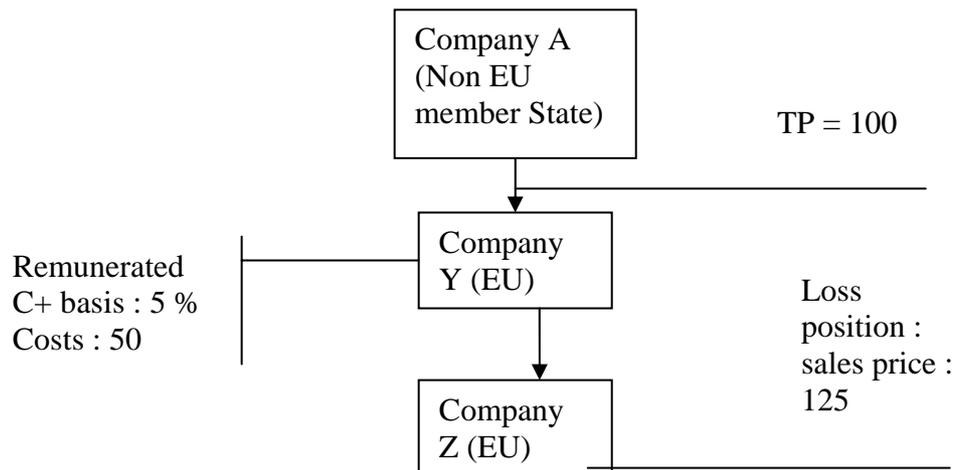
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BELGIUM

“Triangular” MAP cases

Difficulties or disputes arise between MS that have to be solved under MAP. However, these difficulties or disputes may arise because of TP imposed by a company situated in a third country (most often a non EU MS).

Example:



Facts : Company A is a non EU manufacturer of widgets. It sells its products to a local distribution/service centre (low risk, low function) in country Y. The distribution/service centre in country Y sells the goods to the end line distributor in country Z.

Company Z is in a loss position (for a long time). Company Y is in a profit position, but is only remunerated for its actual functions performed and risks assumed on a cost plus basis. Costs included in the cost base are for e.g. salaries, depreciation, ..., but not the TP for the goods for the transaction between A and Y. The pricing between Y and Z is established on the following basis : pricing between A and Y + the cost incurred by Y and appropriate mark up .

E.g. assume the TP between A and Y is 100 (= non AL) and costs incurred by Y for the performance of functions and risks are 50 (= AL). A mark up of 5 % is added (= AL). Therefore, the price charged by Y to Z : $100 + 50 + 2.5 = 152.5$. In the end, company Y only receives an AL-remuneration for its functions. The non-AL-price therefore has no effect on company Y. However, Company Z is only able to sell the widgets at a (market) price of 125 (= AL), leaving it with a loss of 27.5.

The dispute could be brought under the arbitration convention (and the arbitration commission) for the transaction between Y and Z company. However, under the MAP procedure, the competent authorities, and in the end the arbitration commission, could only establish that the remuneration of Y company is correct.

The problem here lies with the initial TP imposed by the non-EU company. It would therefore be advisable that both tax administration of Y and Z combine their efforts in order to tackle the problems that arise in A. Application of the arbitration convention would not solve the problem.

Advantages of combining the efforts of both competent authorities :

European countries would present themselves more as one “block”, applying the same principles and views;

Avoidance of double taxation at multilateral level;

Only one combined map procedure for the companies / group;

Transparency of the case for all the tax administrations involved : all could assist in the MAP between Z and A country.

Problems :

Do MAP procedures under DTA and AC allow this procedure ?

Acceptance of the procedure by other (non EU) countries ?

“Accounting”

There may be room for additional guidance to be developed by the JTPF in the field of accounting. The OECD-guidelines refer to accounting standards in several places, but the main idea that is worked out in the guidelines is that adjustments have to be made in order to :

- ensure the same type of costs are used (2.28)
- reach accounting consistency (2.39, 2.46, 3.9,)

Further, reference is made to the difficulties that arise in map due to i.a. different accounting systems that may lengthen the MAP process (4.52).

Further, when discussing CCA’s, the guidelines state in 8.42 and 8.43 that the manner on how accounting principles are applied consistently to all participants in determining expenditures and the value of contributions is useful information.

However, the guidelines do not give guidance on how this consistency can be achieved, let alone applied.

Problems : specifically for Europe : 25 different GAP for statutory accounts;

For consolidated accounts : IFRS – Useful for MAP or MAP APA’s ?

Consistent translation of a common accounting system (e.g. IFRS) into accounts useful for TP and that can be translated reasonably easy enough for use in domestic GAP.

Classification of certain expenses under of the three major cost groups identified by the OECD guidelines for TP purposes : common understanding of the cost groups and their content :

- Direct costs
- Indirect costs
- Operating expenses

This would not mean that the domestic GAP has to be changed, but for TP purposes a common basis could be applied.

The following (non exhaustive) list could serve as a guidance :

- Trade goods, raw materials;

- Services and miscellaneous goods;
- Wages
- Social security contributions
- Pensions and allocations to pension funds;
- Depreciations and reductions of value of
 - o Tangible property
 - o Intangible property
 - o Preliminary expenses
- Reductions of value of
 - o Stocks;
 - o Orders;
 - o Receivables
- Miscellaneous costs
 - o Marketing
 - o R&D
 - o Market development study
- Exceptional costs
 - o Exceptional depreciation and reduction of value (tangible and intangible property)
 - o Reduction of value of financial assets;
 - o Provisions for exceptional risks and costs;
 - o Losses incurred as a result of the realisation of fixed assets
 - o Restructuring costs

“Monitoring”

Monitoring of the COC on the arbitration convention and on documentation – e.g. evaluation of the COC after 6 months (perhaps too soon), one year, two years, ...

FINLAND

At this time we have no specific suggestions, but would like to mention that we are generally very much in favour of continuing the work of the Forum, as it has been extremely beneficial for us. We are especially interested in the subjects of dispute avoidance and resolution as well as documentation.

FRANCE

Un suivi du devenir des travaux sur la documentation devra être initié par le Forum

GERMANY

1. Triangular MAP/arbitration cases

There may be cases where a (bilateral) MAP or arbitration procedure between two countries is not suitable to resolve their tax disputes. This is the case where the underlying reason for double taxation in respect of two associated enterprises lies in non-arm's length transfer pricing between a third (often non-EU) associated enterprise of the MNE and one of the two enterprises suffering from double taxation. It seems that the OECD so far has not addressed this issue.

Example:

Company M in country M manufactures products and sells these to its European whole sale distribution subsidiary A in country A at cost 100 plus 20% profit mark-up, i.e. at a transfer price of 120. Subsidiary A sells these products on to an associated enterprise B in country B at cost plus 2% (arm's length) profit mark-up. Distribution Company B sells these products on to end customers and constantly makes losses. Following a tax audit at company B a transfer pricing adjustment is made on the basis of the resale price method to arrive at arm's length transfer prices (lower purchase prices) for the products purchased by company B from company A. This transfer pricing adjustment results in double taxation. A corresponding adjustment of country A would result in company A making losses. It follows, that while in a MAP or arbitration procedure between countries A and B double taxation may be eliminated, this could only be achieved at the expense of the tax revenue in country A and/or country B. This result, however, seems unjustified. A satisfactory solution to eliminate double taxation in such cases can only be a corresponding adjustment by country M.

2. Cost Contribution Arrangements (CCAs)

We find it difficult that CCAs, which by nature involve at least two countries, are governed by different rules in the EU. In our view the situation can be compared with bilateral/multilateral APAs where a common approach in the EU, e.g. best practice, seems to be very useful.

In addition, there are significant discrepancies between Member States' rules on CCAs. For example, some Member States require a profit mark up on the allocated cost, some other Member States disallow such a profit element in the context of certain administrative services. Double taxation is the inevitable consequence.

An issue related to CCAs is the influence of (commercial/tax) accounting on transfer pricing. The cost basis to be applied in a cost plus situation, e.g. for a CCA, differs from Member State to Member State because the accounting systems are not harmonised. In addition, some Member States require their national tax accounting system to be the basis for the cost plus method whereas others accept the commercial accounting system.

3. Monitoring and Revision of the Code of Conduct on the Implementation of the Arbitration Convention

An issue not to be considered as a separate topic for the future programme, but a continuous task of the Forum could be monitoring how the Code works in practice and considering a revision of the Code to improve its functioning. In our view, clarifications

as regards the advisory commission, e.g. on the issues of timing and reasoned decision, could be envisaged. Also, the interaction of the mutual agreement and arbitration procedure with administrative and judicial appeals could be revisited (see Articles 7 (1) and (3) of the Arbitration Convention and point 2.5 of the JTPF's activity report from October 2002 - December 2003; Commission Communication of 23 April 2004 COM(2004) 297 final).

In the context of monitoring and revision, the developments at the OECD's Joint Working Group on Dispute Resolution could be discussed and some of the results of the OECD's Joint Working Group could be taken into account in a revision of the JTPF's Code of Conduct in order to align the two approaches to some extent.

The Forum has so far accomplished important work reflected in Commission Communications and proposals for Codes of Conduct on the implementation of the Arbitration Convention and EU Transfer Pricing Documentation. Both issues were considered urgent by the Forum and, therefore, were given high priority.

The Forum's work on alternative dispute resolution procedures, in particular APAs, is expected to be finalised by the end of the Forum's second term. It seems to us that although there still remain important issues to be discussed in the Forum, none of these issues require urgent solutions. Considering that in 2002 it was originally agreed to have two or three Forum meetings per year, we therefore suggest reducing the number of meetings from 2007 onwards to no more than three per year.

ITALY

"Triangular" MAP cases

We have often experienced MAP cases with an EU country where disputes arise because of transfer pricing imposed by a company situated in a non EU country.

In the example by Germany, it is highly likely that the advisory commission charged with delivering its opinion on the elimination of the double taxation will perform its task by asking Country A to make a corresponding adjustment. As the advisory commission cannot deliberate towards Country M (non E.U. country) the double taxation will be eliminated at the expense of tax revenue in country A.

At the moment, we do not have any specific idea on how to solve this problem, but we think that it should be taken into consideration by the Forum as a challenging task to perform.

Arbitration Convention

In our view, the Forum should study some important issues concerning the interaction of the mutual agreement and arbitration procedure with administrative and judicial appeals.

We are mainly referring to Article 7, paragraph 1 and paragraph 3. In the code of conduct, it has not been clarified the starting point of the two years when the taxpayer has recourse to the remedies available to it under internal law of a country which cannot derogate from the decisions of their judicial bodies. Among the countries which the situation in paragraph 3 applies to, a few countries issued specific guidelines in that respect, while other countries did not issue any circular (nevertheless they have of course their position on that).

The interaction of the mutual agreement and arbitration procedure with administrative and judicial appeals is of course an internal matter and the Forum cannot have any influence on that. Nevertheless, it could be extremely useful to know the different positions of the countries and what can happen when the positions are different. Knowing that in advance could accelerate the solution of problems between Competent Authorities and could also give the taxpayer some useful indication on the timing and on the result of its request.

Number of meetings

We suggest reducing the number of Forum meetings to three per year.

MALTA

We would like to suggest that the JTPF addresses, in a future mandate, the question of transfer pricing and SME's. Up to now, this issue has been largely considered in the margins. Considering that the vast majority of enterprises within the EU fall within this category, we feel that the JTPF should give it its due consideration. A number of points come to mind such as:

1. Definition of SME (whether for transfer pricing, the already determined EU definition is adequate);
2. Whether SME domestic transactions should be subject to transfer pricing rules (I believe the UK exempts SME's from rules in respect of UK transactions);
3. The application of safe harbours;
4. Transfer Pricing methods which would be sufficient/acceptable for SME's;

5. The level of documentation requirements.

It is generally an accepted principle that SME's should carry a smaller burden when it comes to transfer pricing, but discussions during the JTPF meetings have shown that this issue is not that straight forward.

I am attaching herewith a copy of the Australian Taxation Office guide entitled "A simplified approach to documentation and risk assessment for small to medium businesses" which you may find helpful in relation to this subject. I would like to point out that the submission of this document should not be taken to mean that we necessarily agree with the contents of this document or that it is a suggestion that the Forum should in any way adopt it or the principles contained therein. It is being sent solely to aid the Secretariat in its research should this subject be taken on board.

Furthermore, we would like to point out that a fruitful discussion on this subject may not result if the Forum has no representation of SME's.

PORTUGAL

Portugal thinks that the Forum might have a role on accompanying application of transfer pricing rules in the EU. It seems however that there is no scope for more Codes of Conduct, and penalties should not be considered a possible object of any kind of Code of Conduct. Two meetings a year seem sufficient for accompanying the above mentioned subject.

SLOVAK REPUBLIC

Future of the JTPF: The Slovak Republic appreciates the professional work carried out by the Joint Transfer Pricing Forum and its efforts in order to improve the situation in relation to transfer pricing issues within EU Single Market. The Forum has already made more than we awaited and for us it is necessary to have a sufficient time and space in order to implement its outcomes in a reasonable way. Therefore, for this moment, the Slovak Republic does not submit any suggestions to the future of the JTPF

SPAIN

Finalisation of the work programme already agreed.

There is still some work to be finalised on issues approved. We need to revise the issues pending and see the feasibility of productive work on them.

Cost contribution arrangements.

MNEs have to deal with different CCA rules in the EU if they want to conclude a CCA. And there are significant discrepancies such as:

Some member States require a profit mark up on the allocated costs, some other disallow such a profit element in most cases.

The cost basis to be applied in a cost plus situation differs from MS to MS.

Influence of national accounting systems. Our aim is not to influence on national accounting systems but to develop further a common classification which could be applied for TP issues, mainly CCA.

All these may lead to double taxation and the Forum could explore practical ways to overcome these problems.

Although our proposal is initially focused on CCA s we understand there is room for further common guidance which may go beyond CCA. Therefore we could discuss the scope for this work.

Multilateral MAP cases within Europe.

More and more frequently there are case which concern more than two countries. There is an adjustment in country A and it affects countries B,C,D.

It is frequent that the issues discussed are of the same nature and the adjustments proposed have common reasoning.

In those cases 3 bilateral MAP cases without any communication among tax authorities may be burdensome for the taxpayer and may delay the process and the elimination of double taxation considered globally.

In those circumstances, following the experience we have on multilateral APA (which has proved to be very successful) we might want to explore if on a voluntary basis there is room for MAP cases to improve on the basis of common negotiation (either during the whole process or partially when considered convenient).

Other issues.

Spain would support working on other issues that may increase common approach even if the work may not necessarily result in a Code of Conduct or a Code of best practice.

Cross-border mergers in future in the EU will lead to an increasing number of PEs which were formerly subsidiaries of the MNE.

In this context the rules for the transformation and also future taxation of the sub/PE, as well as transferral of assets, are important issues.

Although the OECD is carrying out an important project on PE, we believe there is margin for the EU to agree on a common interpretation based on the OECD work which might lead to agreed points of view on this important issue.

We could even explore whether this project could have a wider scope which included business restructuring although the OECD is carrying out work on this issue.

We also believe a project on SME and transfer pricing might be valuable. The project could consist of an analysis of those aspects that may be specially burdensome for SME and propose practical common solutions that may be applicable when there is low risk at stake.

UNITED KINGDOM

The UK thinks that the Forum has so far done valuable work in producing Codes of Conduct on Dispute Resolution and on Documentation. Promising work is also being done on Advance Pricing Agreements. The UK wonders, however, whether there is scope for many more, if any, Codes of Conduct. The scope is limited without getting into areas that are the responsibility of the OECD. Discussions so far on penalties do not suggest that a Code of Conduct will be a likely outcome of that exercise.

A useful future step for the Forum might be to have a general discussion, not linked to specific issues, about current developments in applying transfer pricing rules in Europe. This would be a particular opportunity for the business representatives to give their impression. It is possible that some specific ideas for future work would emerge from such a discussion.

If it appears that the scope for the Forum to produce new outputs, such as Codes of Conduct, may be diminishing, the Forum might want to consider having fewer full meetings. It seems unlikely that there will continue to be a case for having four meetings a year. The Forum might want to consider reducing to two meetings a year.

AUSTRIA

CYPRUS

CZECH REPUBLIK

ESTONIA

DENMARK

GREECE

HUNGARY

IRELAND

LATVIA

LITHUANIA

LUXEMBOURG

NETHERLANDS

POLAND

SLOVENIA

SWEDEN

BUSINESS

1. Generally speaking the Forum is a good platform for business and tax administrations to meet to discuss contentious issues. Even if we are not able to produce a finished product in some of these areas there is still much to be gained by discussing the issues within the Forum. The level of understanding of transfer pricing issues among member states and of tax administration concerns among business has increased significantly since our first meeting and this is of real value.

2. With our current and former program we have covered nearly all procedural matters. Maybe it would be a good idea now to touch practical matters for example valuation of intangibles.

- The Forum could help the EU Commission and the CCCTB effort to understand the difficult technical issues

3. The Forum could be extended to discuss the convergence of the transfer price between Income Tax, Customs and VAT where the interests are currently diverging with Income Tax wanting a low transfer price and Customs and VAT a high one although because in nearly 30 years there were no real technical problems in the different situations. However, there are new developments:

- Joint WCO/OECD Conference on Transfer Pricing and Customs Valuation
- Belgium introduced the arm's length standard into its VAT legislation

4. We are still in the process of discussing APAs. So far we have not discussed other preventive measures, such as alternative ways of dispute settling (e.g. prior consultation between tax administrations before making adjustments). It remains to be seen whether the Forum would be able to discuss this aspect under the current mandate.

5. Arbitration Convention related issues that remain still open :

- rules on suspension of the collection of tax under the Arbitration Convention
- the treatment of interest payments

6. Further issues that have not been put on the agenda for the first and second mandate are the following:

a) Cost Allocation Agreements

There is an increasing trend in tax audits that cost allocation systems are challenged and there are significant differences which documentation has to be prepared to justify a certain cost allocation system. The EU TPD does not help in this respect since it only provides an abstract approach how to prepare documentation.

b) Supply Chain Restructuring

One further issue is the treatment of supply chain restructuring and the treatment of so-called business opportunities. Since e.g. the OECD and the German tax authorities are currently working on a statement paper and administrative principles respectively, it is in our view an issue of major importance which could be discussed in the Forum. Although it is certainly a topic which remains at the legal disposal of the Member States, it could be

helpful to discuss the topic to - at least - examine the different perspectives between the member states.

7. The Forum should review the Member States practice and establish the extent to which the Forum recommendations are actually followed. We should discuss the practical implementation of the various Codes of Conduct that are established by the Forum. On TPD we can see that Sweden, Denmark, Czech Republic, Spain ... are just taking it over in their legislation. For the AC there is no such obvious monitoring.