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TRIANGULAR CASES AND THE ARBITRATION CONVENTION: A PRACTICAL PROBLEM REQUIRING A PRACTICAL SOLUTION

Issue

Article 7 of the Code of Conduct[1] for the effective implementation of the Arbitration Convention recommends Member States to report on the practical functioning of the Arbitration Convention.[2] Amongst other issues, some Member States recently reported the issue of triangular cases and access to the Arbitration Convention as a potential item of concern. To support that determination, however, first of all Member States would need to establish that a triangular case would indeed exist. The burden of proof on this determination may be a lot harder to meet than appears at first sight. Second, presenting the issue raises the potential "threat" of a two-country or three country audit and that possibility in and of itself could very well serve to have taxpayers reconsider filing for avoidance of double taxation under the Arbitration Convention. This would significantly reduce the power of the Arbitration Convention. Also, more often than not, practical problems can be addressed by practical solutions. It is maintained in this analysis that the triangular cases "problem" that has been identified, more likely falls within the category of practical problems than anything else and as such, practical solutions to the problem would probably suffice. Next to offering some practical solutions to address the identified issue, it is maintained that triangular cases should trigger no significant adjustments to the procedure provided under the Arbitration Convention for the avoidance of double taxation and that the conclusion that a triangular case exists should be based on convincing evidence.

A suggestion to address the triangular cases "problem" that would affect access to the Arbitration Convention, in whatever way, would constitute a violation of the spirit and text of the Arbitration Convention and probably also of the Vienna Convention on the Law of Treaties.[3] Any alteration of the workings of the Arbitration Convention could carry with it the potential of crippling the workings of the Arbitration Convention. There appear to be several avenues currently available to resolve triangular cases, again assuming they can be convincingly substantiated, that would leave alone the effect and applicability of the Arbitration Convention. Improvements that would enhance the swift resolution of (possible) double taxation cases are always welcome and to be encouraged, but any action that would reduce or limit access to the Arbitration Convention should be discouraged.

The Arbitration Convention: Background and Purpose

The rapid development of cross-border trade within the European countries after the Second World War resulted in an increase in disputes causing double taxation. As a result of the positive experiences in eliminating double taxation through multilateral and bilateral conventions in the beginning of the 20th century by way of arbitration, the OECD included a competent authority procedure in the first OECD model convention of 1963. This procedure allowed for proceedings through a Commission consisting of representatives of the competent authorities of the

[1] 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, OJ C 176, 28.7.2006, p. 8–12.

[2] 90/436/EEC: Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises, Official Journal L 225, 20/08/1990 P. 0010 – 0024.

[3] Vienna Convention on the Law of Treaties, May 23, 1969, United Nations, Treaty Series, Vol. 1155, p. 331.

Contracting States where this seemed advisable in order to reach agreement. At that time, this was as far as the OECD member states were prepared to go. They agreed to seek a solution, but did not want to commit themselves to find a joint solution to eliminate the double taxation.[4]

The need for means to obtain relief from double taxation within the European Union by way of binding arbitration increased when in 1976 the Directive for Exchange of Information within the European Union was issued.[5] It was expected that the Exchange of Information Directive would result in a relevant increase of double taxation cases in the EU Member States. This resulted on November 29, 1976 in a submission by the EC Commission to the European Council of a proposal for a council directive on the elimination of double taxation in connection with the adjustment of transfer of profits between associated enterprises based on article 100 EC Treaty (now: article 94 EU Treaty) (hereinafter referred to as the Arbitration Directive).[6]

Although the Exchange of Information Directive was adopted in 1997[7], the Arbitration Directive was not adopted and was finally withdrawn on November 21, 1996.[8] The reason for this was that most EU Member States disagreed with the Arbitration Directive. In essence, the primary reason for their disagreement was that they did not want to give up their tax sovereignty which would effectively be the result of binding arbitration. Another reason to reject the Arbitration Directive was that the Member States did not want to be obliged to refer cases to the European Court of Justice, probably for the same reason: not wanting to give up the power to allocate and tax income.

In 2002, the European Commission raised the issue of whether the Arbitration Convention should be converted into a directive again. The European Commission announced its intention to issue a draft directive in 2003 (which, however, was not issued). In 1978, the Netherlands (at that time president of the EU) resolved the deadlock regarding the adoption of the Arbitration Directive by proposing an Arbitration *Convention*, instead of a Directive, based on article 220 EG treaty (now: article 293 EU treaty).

The Arbitration Convention is therefore not an EC legal instrument, but a multilateral convention under international public law. The key difference between a multilateral convention and a directive is that, under a multilateral convention, the EU Member States maintain their tax sovereignty. The European Court of Justice has, in principle, no jurisdiction to interpret and enforce provisions of a convention. Technically, a convention is not subject to Community law, although more recently the EU Court of Justice decisions do indicate that treaties should not be interpreted contrary to or in violation of Community law, and it is argued that double taxation in and of itself may be an obstacle to trade in the common market.[9]

After twelve years, on July 23, 1990, the EC finance ministers of all Member States[10]signed the Arbitration Convention. After the ratification by all twelve (then) EU Member States, the Arbitration Convention became effective as of January 1, 1995 for a five-year term according to Article 20 of the Arbitration Convention.

[4] Commentary paragraph 42 to article 25 of the OECD Model Convention of 1977.

[5] no. COM (76) 119 def. Publication courant of the EC April 27, 1976, no. C 94.

[6] no. COM (76) 611 def. Publication courant of the EC December 21, 1976, no. C 301.

[7] 77/799/EEG.

[8] M.L.B. van der Lande, Handboek International Belastingrecht, Kluwer, 1998, paragraph 0.9.

[9] Lankhorst-Hohorst GmbH v. Finanzambt Steinfurt, December 12, 2002, C-324-00.

[10] Belgium, Denmark, France, Germany, Great Britain, Greece, Spain, Ireland, Italy, Luxembourg, the Netherlands and Portugal.

As Austria, Finland and Sweden joined the EU at a later time, an Accession Convention was signed on December 21, 1995, allowing these States to join the Arbitration Convention.[11] To extend the Arbitration Convention for a period after January 1, 2000, a protocol was issued on May 25, 1999 ("the 1999 Protocol" or "the Protocol"), which amends the Arbitration Convention to the effect that the Convention shall be extended for a further five-year period and shall automatically be extended every five years for a five-year period, unless a Contracting State shall object. This protocol provides that the extension of the Convention takes effect the first day of the third month following the month in which the instrument of ratification is deposited by the last signatory state. The 1999 Protocol was ratified by the last contracting state (Italy) on August 4, 2004. The Convention therefore became effective on November 1, 2004, with retroactive effect as of January 1, 2000, for another five-year period and will thereafter be automatically extended for another five-year period (unless a contracting state objects).

Finally, in order to extend the Arbitration Convention to additional Accession countries, a Convention for the Accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, The Republic of Malta, The Republic of Poland, The Republic of Slovenia and the Slovak Republic to the Arbitration Convention of December 8, 2004, was entered into.

From the above, it becomes clear that the Arbitration Convention, despite its relatively short (and somewhat rocky) life, already has a long history. The role of the Arbitration Convention is far greater than appears at first sight. The scope of the Convention is fairly limited, as it only applies to transfer pricing cases. The consequence thereof being that it can be considered comparable in ranking as a *lex specialis* compared to a *lex generalis*, within treaty context. The former will have priority in application over the latter. One could argue that Member States would actually be required to apply the Arbitration Convention over a regular treaty for the avoidance of double taxation in case transfer pricing issues require competent authority involvement. On the other hand, the Convention is broader than regular treaties for the avoidance of double taxation as it allows access for permanent establishments located in signatory countries (regardless of where the head offices of the permanent establishments are located) to the competent authority process. Regular treaties for the avoidance of double taxation usually require the head office/parent company of a permanent establishment to also be located in a treaty country.

The real power of the Arbitration Convention lies in the fact that it requires competent authorities to fully resolve a case submitted to them. Full avoidance of double taxation must be obtained within a time period of two years. If that deadline of two years is not met, the case is to be handed over to an advisory commission (and out of the jurisdiction of the competent authority process) to resolve the case and obtain full avoidance of double taxation within a six month time period.[12] The advisory commission must decide on the issue within a six month period, yet the competent authorities can have one more bite at the apple, as they have authority to accept another outcome of the issue, provided the alternative solution also provides for full avoidance of double taxation, within another six month period.[13] If they do not reach an alternative solution, the decision of the advisory commission becomes binding.

[11] The Convention on the Accession of the Republic of Austria, the Republic of Finland and the Kingdom of Sweden to the Arbitration Convention of December 21, 1995.

[12] Articles 7 and 14 of the Arbitration Convention.

[13] Articles 11 and 12 of the Arbitration Convention.

The Arbitration Convention is nothing short of a marvel amongst tax treaties. All tax treaties restrict the application of internal tax law. The Arbitration Convention, in addition, obligates the respective competent authorities to hand over jurisdiction to an arbitration or advisory commission for final decision and avoidance of double taxation if they don't achieve that result themselves within a two-year period. The use of arbitration to resolve taxation issues is still relatively rare to date. In the world of international tax and treaties, at the time the Arbitration Convention was established, inclusion of an arbitration option was an incredibly progressive approach that is now rapidly becoming more fashionable.[14]

The two-year time frame provided under the Arbitration Convention constitutes its "raison d'être." In practice it is still to be seen whether the two-year limit included in the Arbitration Convention is as hard and enforceable as it seems and should be. Taxpayers have informally reported on Member State practices extending that two-year term by arguing that the term had not commenced yet, as not all information was obtained, or Member States have requested taxpayers to extend the term voluntarily. In any case, the Arbitration Convention established something that previously was considered unimaginable: Member States agreeing to a relativity short time frame and deadline within which a double taxation case can be (fully) resolved and closed.

Arbitration is generally referenced as being very successful in avoiding double taxation. This is not because the actual arbitration process is a superior mechanism or better procedure to resolve double taxation, however. The success of the Arbitration Convention appears attributable largely to the fact that countries do not prefer to relinquish jurisdiction and say over issues affecting their tax base to (independent) arbiters and prefer to enter into bilateral agreements, despite the tight time frame within which such has to be achieved under the Arbitration Convention. This, in turn, of course leads to swift resolution of competent authority cases

Following the success of the Arbitration Convention, the OECD Model Convention has recently been amended to include an arbitration clause in article 25 paragraph 5.[15] Few treaties have an arbitration clause at the present time, however. Reference can be made inter alia to the Germany-Austria treaty, the US-Germany treaty, the US-Netherlands treaty, the US-Belgium treaty and the Protocol to the US-Canada treaty, all of which suggest an option to arbitrate, provided the respective protocol or treaty articles are ratified and fully in effect. As to the arbitration process, however, it should be pointed out that the arbitration process under the Arbitration Convention

[14] See OECD announcement Feb 7, 2007: "*Arbitration to be an option in cross border tax disputes, OECD countries agree*".

[15] The text of the new paragraph 5 is as follows:

"Where,

a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State,

any unresolved issues arising from the case shall be submitted to arbitration if the person so requests. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph."

materially deviates from that proposed under the OECD Model Convention. This analysis will not compare these differences however.

So it appears to be the mandatory next step of arbitration that is responsible for the improvement in commitment to resolve a case of double taxation within the two-year time limit that is provided under the Arbitration Convention. More recently, regular bilateral agreements on resolution of competent authority cases within a two-year time period have become more popular as well, however.[16]

In sum, it can be concluded that the Arbitration Convention is a most useful and positive addition to the available tools to reduce or minimize avoidance of double taxation. Business has consistently been favourable about the possibility to obtain avoidance of double taxation pursuant to the Arbitration Convention and the Convention is generally also a much preferred avenue over the application of a regular (bilateral) treaty for avoidance of double taxation, because of the mandatory nature to resolve double taxation within the short (2-year) time period.

Triangular cases

1. "Classical" Triangular cases

The term "Triangular cases" in international tax usually denotes the situation where a person who is a resident of one state ("R-State") carries on a business through a permanent establishment in another state ("PE-state") while income from a third state is attributable to this permanent establishment (Source-State or "S-State"), or the situation where a recipient or payor of the income is a dual resident. Situations where entity classification is inconsistent may also lead to a triangular case.

Growing cross-border business by way of permanent establishments is deemed responsible for an increased incidence of triangular cases and taxation in multiple countries. Avoidance of double taxation can only be achieved in this case if R-State and PE-State *both* are willing to provide relief from double taxation.

Considering that treaties for the avoidance of double taxation are bilateral, there is often little formal space to achieve full avoidance of double taxation under one single treaty, however. The treaty for the avoidance of double taxation of the PE-State with the country from which the permanent establishment derives its income (S-State) is usually restricted to *residents* of the two countries. A PE will usually not qualify as resident itself, however.

Unilateral rules for avoidance of double taxation of PE-State may provide relief from double tax as to the income derived by the PE from S-State. An OECD Model Non-Discrimination clause included in the treaty for avoidance of double taxation between S-State and PE-State may provide relief in this instance as well, however. The Non-Discrimination clause provides that taxation of a permanent establishment may not be less favourable than the taxation of enterprises resident in

[16] See: IRS News Release IR-2003-116, Oct. 7, 2003: The U.S. and The Netherlands Develop New Administrative Arrangements for Mutual Agreement Procedure (http://www.irs.gov/pub/irs-news/ir-03-116.pdf) and IRS News Release IR 2000-79: U.S. and U.K. Develop New Administrative Arrangements for Mutual Agreement Procedure (http://www.irs.gov/pub/irs-news/ir-00-79.pdf).

PE-State carrying on the same activities.[17] R-State subsequently should provide relief under the treaty between R-State and PE-State, if full avoidance of double taxation is to be obtained.

It is also considered by connoisseurs that perhaps Article 52 of the EC Treaty (Freedom of Establishment) would require PE-State to provide relief for tax withheld in S-State, as it should apply domestic law without restrictions and provide relief to a permanent establishment of a EU company (assuming R-State and PE-State are EU countries) if it also does so to its own residents, or that Article 24(3)[18] of the OECD Model would have a similar effect because PE State should not tax permanent establishments of R-State less favourable than its own enterprises even if R-State where a Non-EU Country.[19]

2. Triangular cases under the Arbitration Convention

The triangular cases analysis for purposes of the Arbitration Convention, however, is quite different from the more classical triangular cases definition briefly described above. The Arbitration Convention analysis of triangular cases is based on the determination that resolution of double taxation (resulting from a primary adjustment in one State party to the Arbitration Convention) regarding a transaction between two associated enterprises, both of which are resident in States party to the Arbitration Convention, would result in not-at-arm's-length profit margins/prices in the other State as a result of a *third* associated enterprise transaction.

Assuming that an upward adjustment would be made by one State that considers income being underreported in its jurisdiction, such would result in double taxation in the other State. But upon filing for avoidance of double taxation under the Arbitration Convention, it would subsequently appear that a corresponding adjustment in the other State would provide relief to the associated enterprise located in the other State, yet de facto create a not-at-arm's-length or actually a below-arm's-length margin or price at the level of that associated enterprise, and as such deprive the other State from tax revenue. Hence the concern raised by Member States. Application of the Arbitration Convention would lead to one of the two States ending up with a profit margin or prices that can be considered too low, or alternatively both States would somehow end up splitting the difference and as a result both would report a margin or price that is probably considered to be too low. Obviously, neither of these scenarios are particularly welcome to the relevant two States.

The cause of the problem is argued to be an intercompany transaction between one of the two States with a third State that is not party to the Arbitration Convention. Of course, the third State could also be a party to the Arbitration Convention and in that case, the issue would be whether the right transaction was submitted to be resolved under the Arbitration Convention. For purposes of the current analysis, it is assumed that the third State is not party to the Arbitration Convention, however.

[17] It should be referenced here that not all countries give such relief but that a majority does appear to do so. See also: "Triangular Treaty problems: A summary of the Discussion in seminar E at the IFA congress in London," by John Avery Jones and Catherine Bobbett, 1999 IBFD Bulletin, January 1999.

[18] This article provides that taxation of PEs of enterprises of a Contracting State located in another Contracting State shall not be less favorable in that other State than the taxation levied on enterprises of that other State carrying on the same activities.

[19] See Footnote 18 supra.

In case a filing would be made under the Arbitration Convention for relief from double taxation in the above scenario, the workings of the Arbitration Convention would demand a solution from the respective competent authorities within the two-year time period. In case they would fail to reach such timely result, the case would be handed over to the advisory commission for arbitration with a mandate to obtain full avoidance of double taxation. The Arbitration Convention does not provide for exceptions once a case qualifies for resolution under the Convention and has been timely filed. The two-year time period starts running after filing the request and after two years within which no avoidance has been obtained. At that time, the case qualifies for review by the advisory commission. This is where the power of the Arbitration Convention lays, yet also the most pressing reason why the triangular cases issue is being raised as a problem.

If a treaty for the avoidance of double taxation other than the Arbitration Convention had been involved, the issue would not have been as pressing, as those treaties generally have no predetermined time limit within which double taxation issues are to be resolved. Furthermore, there would be no inherent risk that the issue would be taken out of the jurisdiction of the respective tax authorities and handed over to an advisory commission for arbitration.[20] Furthermore, competent authorities tend to *endeavour* to resolve double taxation under bilateral treaties for avoidance of double taxation, whereas the Arbitration Convention provides for *mandatory* and *full* resolution of double taxation. These three aspects (the 2-year time-frame to resolve, the mandatory arbitration and full avoidance) make the Arbitration Convention a much preferred tool for taxpayers but also make it somewhat of a threat to (the authority/jurisdiction of) tax authorities.

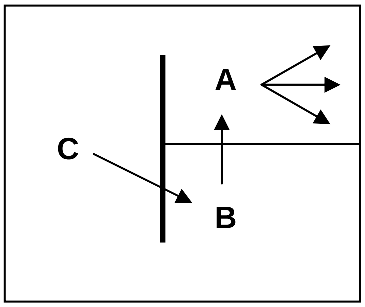
Although there is certainly understanding for the argument that the above fact pattern can present significant practical (and potentially financial) difficulties for the respective tax authorities, question is whether this fact pattern is realistic and whether it in and of itself requires drastic legal measures and changes to the Arbitration Convention procedure. Practical solutions, again assuming there would be a clear cut case, may make sense, but any change to the procedures provided by the Arbitration Convention and its priceless access to swift and timely resolution of double taxation would appear unnecessary. In real life, associated enterprise transactions are that integrated that it is easy to see how the operating income margins of two associated enterprises or prices for transactions between these two associated enterprises can nearly always be deemed influenced by interactions between these two associated enterprises and other associated enterprises. If the issue presented leads to the door being opened to some form of exception to the Arbitration Convention or reduction of rights for taxpayers, it is quite possible that access to the Arbitration Convention would become a rarity and the Arbitration Convention would for all practical purposes be nullified. The mere concern to be subjected to another audit and consecutive adjustments based on the first adjustment would probably already be sufficient for taxpayers to reconsider availing themselves of the Arbitration Convention.

An example within the context of the triangular arbitration cases analysis can be described as follows: There are three associated enterprises, two of which are located within the European

[20] Where the new paragraph 5 to Article 25 of the OECD Model Convention provides for arbitration as a solution for the MAP, the new provision does not envisage that a case is submitted to arbitration without prior approval from all relevant parties, whereas the Arbitration Convention cedes authority to an arbitration commission entirely and automatically.

Union. One associated enterprise sources raw materials outside the EU and is located outside of the EU (Company C). This company manufactures parts/components. The other associated enterprise (located within the EU) serves as European warehousing/assembly entity (Company B) and the third associated enterprise (also located within the EU) serves as European distributor (Company A) and makes sales to unrelated parties within the EU market.

The facts can be presented in simplified format as follows:



Company A is audited and the tax authorities of Country A propose a transfer pricing adjustment because they are of the opinion that the operating profit margin of Company A appears to be not at arm's length (below the range of benchmarked comparables). As a result, an adjustment is proposed by Country A and a corresponding adjustment is required at the level of Company B in order to avoid double taxation. Yet Company B, upon closer review, appears to be compensated at arm's length for its assembly/warehousing function, or at least its profit margin falls within a benchmarked range of comparables. Company B is de facto a service provider, who essentially applies a cost plus method for determining its arm's length return. Based on this finding, the tax authorities of Country B are not that eager to provide for a corresponding adjustment for the benefit of Company B when the issue is presented in a (timely) filing for relief of double taxation under the Arbitration Convention by Company A.

Upon closer review, it turns out that if the purchase price paid by Company B for components purchased from Company C were to be reduced, Company B could still report an arm's length margin and Company A would be enabled to report an arm's length margin as well, due to the fact that the cost of goods sold of Company A (consisting of the items purchased from Company B) would be reduced. For the purposes of our facts, country C is not a party to the Arbitration Convention. Furthermore, the transaction between Company C and Company B is technically not subject to review under the request for avoidance of double taxation regarding Company A and B, filed under the Arbitration Convention. Let's assume it is also not known at this time whether Company C actually reports an (above) arm's length margin for its functions performed in Country C, which would be relevant to know, however.

The above fact pattern has lead to the observation that application of the Arbitration Convention would not solve the (real) problem (being that Country B is not that excited about providing for a corresponding adjustment based on the facts at hand). This observation appears to serve to infer that: (i) the MAP process will not be concluded within two years; (ii) resorting to the regular MAP process may be the only road to a possible solution, and (iii) the Member States party to the Arbitration Convention do not wish an advisory commission/arbitration procedure to address the issue. Although several solutions could be considered to address the incidence of double taxation in this case example, the implicit conclusion to reconsider application of the Arbitration

Convention in this scenario may simply be too easy and furthermore, could prove to be so attractive an argument for tax authorities that it could be replicated for other reasons and constitute the beginning of the end of the Arbitration Convention.

In case the MAP procedure under the Arbitration Convention regarding the primary adjustment made by Country A does not timely get to avoidance of double taxation during phase 1 (the two-year time limit of Article 7), the advisory commission likely will get to that during phase 2 (the 6-month time limit of Article 11), based on the instructions and authority granted to it under the Arbitration Convention. If the facts are as straightforward as presented in the above case example, chances are that Country B will be instructed to provide for a corresponding adjustment by the advisory commission. The mandate of the advisory commission is to resolve the issue between the two EU Member Countries with an opinion based on Article 4 of the Arbitration Convention. The latter article clearly prescribes that in case of associated enterprises, and in case conditions are made or imposed between the *two* enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but by reasons of those conditions, have not so accrued, may be included in the profits of that enterpriser and taxed accordingly. Article 4 leaves little if any space to consider a third associated enterprise.

It is therefore up to Country B, in that case, to proceed with discussions and a MAP procedure with Country C, if it deems such pertinent to protect its (Country B) tax base. That solution, although highly logical and straightforward, obviously has drawbacks:

(1) The Country B authorities will have to first absorb the corresponding adjustment resulting from the primary adjustment proposed by Country A and will have to provide for avoidance of double taxation;

(2) Only in a subsequent MAP procedure with Country C can Country B address the cause and "culprit" of the double taxation: pricing at the level of Company C. There is always a risk that the tax cost of the corresponding adjustment granted by Country B was not sufficiently substantive to invest in that effort and that in light of resources and other priorities, it is more desirable for Country B or convenient to ignore the transaction between Company B and Company C, at the expense of revenue for Country B;

(3) Alternatively, Country B will have to subsequently start up a MAP procedure with Country C. But can this actually be done by Country B absent the imposition of a (primary) adjustment relating to the taxable income of Company B? All information obtained or generated during a MAP process is fully protected by the confidentiality provisions of the applicable tax convention, specifically the Exchange of Information Article (Article 26 of the OECD Model Tax Convention) and in almost all cases by domestic legislation, as would be the case for domestic issues.[21] Also, there appears to be no double taxation (yet) when Country B provides for a corresponding adjustment as it regards the Country B and Country A transaction. This would only be the case if Country

[21] The OECD Memorandum on Effective Mutual Agreement Procedures in paragraph 6.3 does make reference to rare instances where such seems possible by stating: "*Although not typical, a competent authority may, in rare cases, initiate competent authority proceedings and subsequent discussions without a specific request from a taxpayer in any situation where there is taxation not in accordance with a tax convention in order to protect domestic interests*." This appears to allow such discussions under specific circumstances. When a case qualifies as a "rare case", is not clear, however.

B would make a (primary) adjustment. So it needs to be carefully determined whether there is actual access to a subsequent MAP procedure based on these facts.

Considering the lack of resources the competent authority offices tend to have, Country B will not be very excited by the steps required to initiate a subsequent MAP procedure. Looking at Article 4 of the Arbitration Convention there appears to be no option to somehow "pull in" Country C into the Arbitration Convention procedure, as:
(1) it officially is not an EU Member Country, and
(2) the Arbitration Convention itself does not envisage such action.
"Regular" treaties for avoidance of double taxation based on the OECD Model Convention do not seem to envisage that possibility either, yet traditional (classical) triangular cases do seem to require a similar solution: avoidance of double taxation in two other States based on an adjustment in one State. In the latter case, the burden of double taxation is on the taxpayer, however, whereas in the triangular cases scenario, the burden of (a corresponding adjustment for avoidance of) double taxation (without a commensurate adjustment in Country C) appears to be on the Member State (B).

The facts and case example presented above are, for reasons of this analysis and discussion, relatively straightforward. That said, it should be clear that as we are dealing with multinational entities that engage into multiple intercompany transactions simultaneously, not at arm's length margins can result from many different transactions or issues. If the benchmark analysis is performed at operating profit level, any item listed as operating expenses resulting from an intercompany transaction may influence the bottom line operating profit margin: marketing expenses paid to the headquarter office for a centralized marketing campaign, perhaps even interest charges related to intercompany loans issued by a financing subsidiary or sister company (assuming we are not looking at EBIT or EBITDA), or items charged under another related entity transaction reflected in the operating expenses. Furthermore, the cost of goods sold by Company C may very well in turn be derived from intercompany transactions by Company C not (yet) presented in this case example. There is no absolute certainty that it is (solely the) cost of goods sold and the actual merchandize/components obtained from Company B that are responsible for the underreported profit margin at the level of Company A. The costs of goods sold from Company C may itself be the result of several intercompany transactions. Most likely, a combination of factors and transactions should be considered here. And similarly, cost of goods sold at the level of Company B may (also) be affected by more than one related party transaction, being a transaction other than the transaction with Company C. So in reality, the triangular issue opens the door to us probably needing to consider quadrilateral, pentagonal or even more complex cases, and the burden of proof on a tax authority to establish the actual triangular situation, should be considerably high, before any relevant action could be considered.

Reasons why the triangular (or quadrilateral or pentagonal) cases argument is not sufficiently urgent to alter (or bar access to) the existing procedures under the Arbitration Convention

1. Formally, the underreported income of Company B can be addressed in a (subsequent) MAP procedure between Country B and C.

The wish to reconsider the application of the Arbitration Convention to these types of triangular (or more complex) fact patterns appears understandable at first glance. It is Company C's pricing that causes the distortion, it seems, and Company C is “clearly” the culprit under the presented fact pattern. Country C is not an EU Member Country so the Arbitration Convention appears to not allow any liaison with Country C for purposes of addressing the issue. Yet the transaction between Company B and Company C can, of course, be reviewed in addition to the transaction between Company B and Company A. All that would be required to do so is the initiative of Country B to apply a transfer pricing adjustment (bearing in mind that for a cost plus analysis, not only the cost plus margin requires review, but also the cost base) as it relates to the transaction between Company B and Company C. First of all this can be done to keep the relevant years open, and second, to address the transaction between Country B and Country C, that is deemed to affect the Country A tax base in the end.

A filing under the Arbitration Convention (only) requires a resolution of that particular (diagonal) transaction (that is: the transaction between the identified *two* associated enterprises; Company A and Company B) for which the filing is made. There is no reason to bite off more than one can chew at once here, it seems. In case the facts upon review present the possibility that Company C’s pricing of products sold to Company B is (one of) the major cause(s) of concern, the tax authorities of Country B ought to take immediate action to safeguard their rights as it regards the revenue resulting from the transaction between Company B and Company C (considering the deadline of two years within which they have to resolve the matter between Country A and B and considering the statute of limitation under domestic law of Country B) to be able to make adjustments, and Country C to make (corresponding) adjustments. All of this not being un-similar to the actions taxpayers have to take when one country proposes an adjustment: the filing of a protective claim in the other jurisdiction to safeguard their rights to avoidance of double taxation. So the action required by Country B to safeguard its rights to revenue could be considered as a standard procedural action item. The transaction between Company B and Company C can be reviewed and resolved separately under the treaty for the avoidance of double taxation between Contracting State B and Contracting State C, provided such is done timely.

Articles 1 and 4 of the Arbitration Convention envisage (solely) addressing a transaction between (two) associated enterprises resident in Countries party to the Arbitration Convention. Article 15 of the Arbitration Convention provides in relevant part that “*nothing in the Convention shall affect the fulfilment of wider obligations with respect to the elimination of double taxation in the case of an adjustment of profits of associated enterprises resulting either from other conventions to which the Contracting States are or will become parties or from the domestic law of the Contracting States*” from which it can be concluded that Country B is (indeed) free to take action as it regards the transaction between Company B and Company C under the applicable treaty for the avoidance of double taxation between Country B and Country C. Article 15 seems to allow the authorities to freely pursue avenues under other treaties to avoid (subsequent) double taxation, even though a theoretical drawback for the taxpayer here could be the exposure to getting entangled in a waterfall of procedures, or cascading procedures.

2. “Pacta sunt servanda”

Treaties are official agreements between the Contracting States. A tax treaty is an official agreement between two countries on the administration of taxation when the domestic tax legislation of the two countries applies simultaneously to a particular issue or taxpayer (e.g., when a taxpayer resident in one country derives income from sources in the other country). The

Vienna Convention on the Law of Treaties constitutes a codification of pre-existing customary international law on treaties, and as such governs interpretation and application of treaties.

Not applying the Arbitration Convention to the transaction submitted for resolution between Country A and Country B because of the (unfavourable) consequences for Country B could be deemed a violation of Article 26 of the Vienna Convention on the Law of Treaties. Article 26 of the Vienna Convention provides in relevant part that "Pacta sunt servanda": every treaty in force is binding upon the parties to it and must be performed by them in good faith. In case the Member States to the Arbitration Convention maintain that the Arbitration Convention would not apply to the transaction under review, it is more likely than not that access to the Arbitration Convention between the two Member States could be successfully enforced in a Court of Law by the taxpayer. The potentially unfavourable consequences for Country B when granting a corresponding adjustment appear to not be a relevant consideration from the perspective of the Arbitration Convention.

That the Arbitration Convention would not allow for the interpretation that it cannot be applied to the initial transaction (between Company A and Company B) submitted for resolution of double taxation can also be determined based on Article 31 of the Vienna Convention. Article 31 provides that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. Supplementary means of interpretation can be used in case the application of Article 31:
(*a*) leaves the meaning ambiguous or obscure; or
(*b*) leads to a result which is manifestly absurd or unreasonable.

Considering the fact that Country B can invoke the mutual agreement process under the treaty for the avoidance of double taxation between Country B and Country C to address a possible underreporting of income within Country B, the question can be posed whether moving forward with the filing under the Arbitration Convention as it regards the transaction between Company A and Company B would be objectionable. In reality, the procedure between Country B and Country C can most likely be entered into largely simultaneous with or after having granted a corresponding adjustment pursuant to the Arbitration Convention filing regarding the transaction between Company B and Company A.[22] As such, the application of the Arbitration Convention between Country A and Country B would not appear to cause a result that is manifestly absurd or unreasonable for Country B.

3. Practical and legal extensions of the workings of a bilateral agreement or treaty to third parties appear possible.

Tax conventions provide a means of settling on a uniform basis the most common problems that arise in the field of international double taxation. A multilateral treaty has several parties and establishes rights and obligations between each party and every other party. Bilateral treaties by contrast are negotiated between a limited number of States, most commonly only two, establishing legal rights and obligations between those two states only.[23] That said, considering

[22] See reference to paragraph 6.3 of the MEMAP in footnote no. 21 supra.

[23] If real life serves as guidance, a bilateral treaty can actually have more than two parties, however (provided all parties agree, of course). Reference can be made to the bilateral treaties between Switzerland and the European

the fact that multilateral APAs exist, there is also proof of the fact that a transfer pricing discussion between two countries can be extended to three (or more) countries, as long as there is an interest by all parties and a sense of sufficient importance regarding the issue involved, to agree on the matter by way of a multilateral APA. A multilateral APA may consist of one single agreement signed by all three (or more) Contracting States or *de facto* of a series of bilateral agreements applying the same method, assuming the same facts: one between two Contracting States that is mirrored by agreements between the two earlier mentioned Contracting States and a third Contracting State, technically consisting of three bilateral agreements of a similar nature and scope, relating to different jurisdictions. Ideally, these are entered into at the same time, but nothing seems to object to one bilateral agreement being entered into first, and the two others being entered into at a later point in time. The only difference here is that APAs are usually intended to operate prospectively and the presented case example regards back years. In reality, however, APAs are rarely concluded before the transaction(s) in issue take(s) place. Usually they are finalized after the commencement of the first year to which they relate and several of the transactions have usually already taken place at that time. So it would seem that with some positive thinking, a third State could be involved in a parallel process, even though not officially included within the Arbitration Convention procedure.

Article 34 of the Vienna Convention provides in relevant part that a treaty does not create either obligations or rights for a Third State without its consent. That said, rights (and obligations) can be extended to a Third State according to the Vienna Convention pursuant to Articles 35 and 36, all assuming at the very least acceptance of such rights or obligations by the Third State, of course.[24] As such, considering the trend of urging resolution of bilateral disputes and double taxation within a two year time period, and the fact that not more than mere prudence or due diligence would be is required to guard statutes of limitations, just as for taxpayers, triangular cases under the Arbitration Convention would appear to not necessarily require additional legal action, or in any case, appear not sufficiently pressing to alter the workings of the Arbitration Convention as they currently apply. If Country C deems the issue sufficiently important (i.e., the numbers sufficiently large) to agree to be subjected to the obligations of the Arbitration Convention and granted the rights of the Arbitration Convention for purposes of the transaction under review, it will most likely also have a significant interest in a swift and pro-active solution

following the Swiss rejection of the European Economic Area agreement. Each of these treaties has multiple parties. However, these should probably still be considered bilateral, not multilateral, treaties. The parties are divided into two groups, the Swiss ("on the one part") and the EU and its Member States ("on the other part"). The treaty establishes rights and obligations between the Swiss and the EU and the member states severally; it does not establish any rights and obligations amongst the EU and its Member States. Each of these treaties has multiple parties. These should probably still be considered bilateral, not multilateral, treaties. The parties are divided into two groups, the Swiss ("on the one part") and the EU and its Member States ("on the other part"). The treaty establishes rights and obligations between the Swiss and the EU and the member states severally; it does not establish any rights and obligations amongst the EU and its Member States.

[24] Article 35 regards: *Treaties providing for obligations for Third States*
"*An obligation arises for a Third State from a provision of a treaty if the parties to the treaty intend the provision to be the means of establishing the obligation and the Third State expressly accepts that obligation in writing.*"
Article 36 regards: *Treaties providing for rights for Third States*
"*A right arises for a Third State from a provision of a treaty if the parties to the treaty intend the provision to accord that right either to the Third State, or to a group of States to which it belongs, or to all States, and the Third State assents thereto. Its assent shall be presumed so long as the contrary is not indicated, unless the treaty otherwise provides.*"

of the matter raised by the Country B authorities, and as such be cooperative to resolve the issue between Country B and Country A within a two-year time-period. The extension of rights and obligations under the Arbitration Convention would solely regard the Company C – Company B - Company A transaction, and as such, could for all practical purposes probably be agreed between Country A, Country B and Country C, just for the occasion, excluding all other signatories to the Arbitration Convention.

Practical solutions

All in all, solutions appear to exist to address the issue at hand as it regards Country B. It is immediately admitted that practical difficulties or inconveniences remain, but Country B loses no rights when the Arbitration Convention proceedings follow their course, provided it takes action. The only difficulty for Country B appears to be timing issues that create a potential problem if the authorities of Country B are not vigilant and do not act swiftly to protect their tax base.[25] In light of this, it may be relevant to note that there appears to be a significant group of multinationals that does not file for avoidance of double taxation in case of adjustments. With the exception of large, visible, politically relevant cases or taxpayers, the cost and effort of filing for avoidance of double taxation often is deemed prohibitive, plus that there is usually no desire amongst taxpayers to be subjected to yet a(nother) detailed review or audit in Country B. In that case, Country B would not even have an issue, obviously.

When solutions are considered to address Country B's problem or concern, as presented in this analysis, it should be considered that the Arbitration Convention is one of the few international instruments that really seems to encourage and persuade taxpayers to file for avoidance of double taxation. The two year time limit for competent authorities to obtain a result is considered attractive to taxpayers or at least convincing enough to dare to file a request and the promise of complete avoidance of double taxation is very attractive. The Arbitration Convention also allows (US) taxpayers some welcome relief for FIN 48 purposes. The full avoidance of double taxation clause (Article 14) of the Arbitration Convention allows taxpayers to remove reserves set aside for tax adjustments and resulting double taxation from their books and records, as full avoidance of double tax appears safeguarded under the Arbitration Convention. In light of that, the following practical solutions (or variations thereof) may be helpful or be considered:

A. Coordinated and swift action by the tax authorities of Country B to commence discussions with Country C.

Considering the recent trend included in the Memorandum on Effective Mutual Agreement Procedures (MEMAP)[26] swift resolution of MAP procedures (i.e. within two years) is highly recommended.[27] The MEMAP consists of a manual that is part of a broader project to improve the functioning of existing international tax dispute procedures and to develop supplementary dispute resolution mechanisms. While the MEMAP does not impose a set of binding rules upon

[25] Similar timing issues exist for taxpayers and similarly, taxpayers have to be vigilant and determine whether the amounts involved merit the filing of a protective claim and pursuing avoidance of double taxation.

[26] Manual of Effective Mutual agreement Procedures ("MEMAP") of 13 March 2006 issued by the OECD Centre for Tax Policy and Administration.

[27] See paragraph 3.9 of the MEMAP**: "***Whilst the time taken to complete a MAP case may vary according to its complexity, most competent authorities endeavor to complete a case within two (2) years from the date of acceptance of the taxpayer's MAP request.***"**

tax authorities or taxpayers, it is intended to describe recommended approaches for conducting MAP activities. The best practices for the MAP developed by the MEMAP will facilitate and support the resolution of double taxation cases and other cases eligible for MAP consideration, while remaining general enough to be applicable to most jurisdictions.

The MEMAP offers some suggestions that may assist in resolving the issue presented, or at the very least, allow for a flexible approach as it regards the treaty for the avoidance of double taxation between Country B and Country C. Reference can be made to Best Practice suggestion Nº9: "Avoiding exclusion from MAP relief due to late adjustments or late notification."[28]

The text of the Arbitration Convention does not allow for an exception to access the Arbitration Convention procedure once a case qualifies. The two-year deadline appears a solid one as well. However, there is no reason why, if all three countries (Countries A, B and C) act pro-actively, the issue could not be addressed (nearly) simultaneously in all three jurisdictions, by way of parallel discussions. Of course, this would assume the tax authorities follow the existing procedures and act in an organized fashion.

It could be envisaged that Company B would be advised of the findings of the competent authority of Country B that they are of the opinion that the source of the problem rests with the Company C-Company B transaction. In that case, the taxpayer could be advised that a pro-forma adjustment will be made as it regards the Company C – Company B transaction and/or that a MAP procedure will be invoked regarding the arm's length nature of that transaction. To minimize administrative efforts on both sides the taxpayer can in turn act pro-actively and submit transfer pricing documentation as it regards Company C, of course, to determine if indeed the pricing by Company C is to blame.

If the finding of the tax authorities of Country B is actually correct, that the distortion arises due to the Company C – Company B transaction, it would appear that the taxpayer cannot object to a review of the latter transaction. In the end, the taxpayer probably solely seeks full avoidance of double taxation, although a second review procedure would, of course, not be attractive. Whether the findings of the tax authorities in Country B are correct is a major presumption, however, considering that multiple aspects may influence the company's (operating) profit margin(s) and it is to be expected that only in a restricted number of cases the argument can be legitimately raised.

[28] Best Practice Rule 9 provides in relevant part: "*When an adjustment has the potential to give rise to a MAP case, tax authorities should notify the taxpayer as soon as possible of their intention to make the adjustment. Double taxation may arise if one country makes a late adjustment and the other country is unwilling to grant relief through MAP because of time limitations in its domestic law. Some countries are unwilling to implement a MAP agreement by granting relief which is time-barred under their domestic law, even where the convention states that they are obligated to do so. Where the obligation of implementing mutual agreements notwithstanding domestic time limits is explicitly stated in the convention, a good faith application of the convention requires adherence to that obligation. In general, countries should adapt their domestic laws, if necessary; to ensure that domestic time limits do not effectively prevent taxpayers from obtaining relief through MAP. The allowance for protective claims or notification, whether domestically or within MAP, is considered beneficial in affording taxpayers the right to address issues in MAP without foregoing domestic recourse*."

B. Resolution of the issue prospectively by way of a(n) (multilateral) APA.

One can also envisage the Country B tax authorities requesting Company B to enter into an APA for prospective years regarding the transactions between Company C and Company B, or even the transactions between Company B and C *and* Company B and A both, in order to avoid the issue to continue to arise for prospective years. Although this could indicate good faith on behalf of the taxpayer, and in return, Country B could consider leaving the back years alone or negotiate to roll back the solution found in the APA to the years in issue as it regards Country C, it should be considered that the cost and time efforts required for entering into (multilateral) APAs may present significant drawbacks. That said, it can be envisaged that in certain situations, this may provide for a possible practical solution.

C. Extension of the Arbitration Convention to a Third State

The Arbitration Convention provides great relief for the adjustment raised by Country A because of the embedded guarantee that double taxation will be resolved between Country A and B. Enduring a subsequent audit in Country B was not something bargained for by Company B, however. In case the competent authorities of Country B are convinced that the source of the problem rests with the Company C - Company B transaction and they want to use the option offered under Articles 35 and 36 of the Vienna Convention, they may, of course, contact the competent authorities of Country C. Rights (and obligations) can be extended to a Third State according to the Vienna Convention pursuant to Articles 35 and 36, assuming acceptance of such rights or obligations by the Third State.[29] Therefore, it could be envisaged that Country B and Country A engage in discussions with Country C regarding the progress of their discussions and may request whether Country C would be willing to provide for avoidance of double taxation as well, regarding the years in issue, as the issue presented has a bearing upon the Company C - Company B transaction making up the supply chain for the multinational entity of who Companies A, B and C are subsidiaries/members. It is not likely that Country C would voluntarily submit to an arbitration procedure as well, and if it would, such would create it own sets of procedural questions, but it appears that on a bilateral or trilateral basis, the three countries could agree to address the issue presented.

In the mean time, the two-year time limit of Article 7 of the Arbitration Convention would continue running, so this would require relatively swift action by Countries B and Country C, but this would not necessarily be unreasonable, particularly not now that a two-year time threshold for resolving competent authority matters seems to become the norm as applied in separate bilateral agreements anyway.[30] The two-year term is also included in regular treaties for the avoidance of double taxation when paragraph 5 is added to Article 25 of the OECD Model Convention.[31]

[29] See footnote 24 supra.
Article 36 regards: *Treaties providing for rights for Third States*
"*A right arises for a Third State from a provision of a treaty if the parties to the treaty intend the provision to accord that right either to the Third State, or to a group of States to which it belongs, or to all States, and the Third State assents thereto. Its assent shall be presumed so long as the contrary is not indicated, unless the treaty otherwise provides*."

[30] See footnote 16 supra.

[31] The text of paragraph 5 is envisaged to be as follows: "*Where,*

D. Extension of the two-year term

A more risky solution, if the competent authorities of Country A and Country B determine within the two-year term of Article 7 that the cause of double taxation lies with the transaction between Company C and Company B, could be that they consider invoking paragraph 4 of Article 7[32]. That is, by mutual agreement, and with the agreement of the associated enterprises concerned, the two-year time limits of paragraph 1 of Article 7 may be waived. This approach does significantly challenge the "raison d'être" of the Arbitration Convention, however. Eliminating the two-year term is like cutting Samson's hair, leaving him (and in our case the taxpayer) defenceless.[33]

This solution would therefore only be viable, provided it can be sufficiently evidenced that the Company C - Company B transaction and its pricing is indeed the culprit and cause of the (assumed) transfer pricing distortion observed. Chances are that this evidence will not be as persuasive as the tax authorities would want us to believe, however, considering the required burden of proof to accept this solution and that the taxpayer therefore would not be amenable to this option.

The benefit of this option would be that the Arbitration Convention and its procedures technically remain in full force and effect and that no exclusion clauses or complicated mechanisms would appear to be required. The major disadvantage of using this option to extend is the possibility of having authorities (trying to) strong-arm taxpayers into a postponement of the application of the arbitration provision and access to the advisory committee by "threatening" a (full) transfer pricing (or other) audit in Country B. That, in and of itself, would constitute a violation of principles of proper administration and a violation of administrative law.

In case this option/solution is pursued, it is strongly recommended that parties agree on the term of the extension of the two-year term in advance as well, and do not agree to an open-ended

a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State, any unresolved issues arising from the case shall be submitted to arbitration if the person so requests. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph."

[32] Paragraph 4 provides in relevant part: "*The competent authorities may by mutual agreement and with the agreement of the associated enterprises concerned waive the time limits referred to in paragraph 1*".

[33] Samson is a Herculean figure, who used tremendous strength to combat his enemies and perform heroic feats unachievable by ordinary men. He falls in love with Delilah, who is bribed by the Philistines to find the secret of his strength. Once he tells Delilah that his strength is in his hair, she has it cut and leaves him defenseless against the Philistines.

extension. That way, the taxpayer's rights would be safeguarded and the tax authorities would be able to pursue an equitable resolution, by involving Country C.

There are many aspects that need to be carefully considered before this option should be accepted, however. Most importantly: (1) does the size of the corresponding adjustment issued by Country B merit the effort and time and risks of the additional review and (2) what is the likelihood of successfully maintaining that the Company C- Company B transaction is not at arm's length. Considering that Country B will have the burden of proof vis-à-vis country C in case a corresponding adjustment is sought in Country C, the tax authorities of Country B should be well prepared to present their case in this scenario. It goes without saying that this would be the least preferred practical solution for taxpayers.

E. Transfer Pricing Documentation

At the core of the issue presented lies the transfer pricing documentation made available by the taxpayer. If transfer pricing documentation provides organized information on the company's supply chain, it should be possible for tax authorities to filter out potential triangular cases and consider an efficient approach up front to determine whether not-at-arm's length reporting may result indirectly from other transactions. This would undoubtedly aide a swift detection of such situations and allow for early MAP discussions, or perhaps if deemed necessary, formal requests for information between Member States.

The Code of Conduct on transfer pricing documentation for associated enterprises in the European Union actually suggests including information that could be relevant for this purpose in the masterfile where it is stated that a general description is required of the controlled transactions involving associated enterprises within the European Union (flows of transactions, invoice flows and amounts of transaction flows) but also required is a general description of the multinational's organizational, legal and operational structure, including an organization chart, a list of group members and a description of the participation of the parent company in the subsidiaries.[34]

The above suggestions serve to show that tools appear to be available for the tax authorities to address the issue of triangular cases under the Arbitration Convention, although admittedly, this option would also require a pro-active approach and analysis to meet deadlines and obtain acceptable results.

Conclusion

Based on feedback from taxpayers and practice experience, there seems to be a relatively significant group of multinationals that does not file for avoidance of double taxation in case of adjustments, either because they do not want to spend the time and expenses required in general to obtain avoidance of double taxation or because they do not want to trigger a new possibility for being audited (by the Country C authorities). Except for large, visible, politically relevant cases or taxpayers, the cost (in time and resources) and effort of filing for avoidance of double taxation often is deemed prohibitive. The Arbitration Convention is one of the first international instruments that actually truly encourages and persuades taxpayers to file for avoidance of double taxation, although this avenue is solely available for EU Member States.

[34] See: Annex to the Code of Conduct, Section 1 (Content of the EU TPD), paragraph 4.2 (a) and (d).

The main reason the issue of triangular cases appears to be raised under the Arbitration Convention seems to be the hurdle of the two-year term within which the competent authorities have to resolve double taxation, before the matter is handed over to the advisory commission and is transferred outside the scope of the competent authorities. This feature of the Arbitration Convention, next to the two-year term for the competent authorities to conclude an agreement, constitutes its core strength, and is its hallmark (hence the popular reference "Arbitration Convention"), however. The threat of having to hand over jurisdiction to an advisory commission is proving to be highly effective in getting MAP procedures concluded timely. If the EU Member States were to now woo taxpayers into giving up access to the advisory commission in any way, such could be the onset of the end of the Arbitration Convention, or may significantly weaken its power.

Are drastic solutions needed to address the issue presented by triangular cases under the Arbitration Convention? Probably not. Clearly taxpayers (and tax authorities alike) will not be that excited by another audit and a potential adjustment for Company B, after an adjustment having been imposed on Company A. Each audit carries with it a claim on valuable and scarce resources and the potential that other issues will be raised. Risk management requires the avoidance of simultaneous or subsequent audits, if only for purposes of peace of mind for management and shareholders. The triangular discussion diminishes confidence of taxpayers that they could obtain full avoidance under the Arbitration Convention within the two-year term and raises (the possibility of) a subsequent review of the transaction between Country B and C. Whether a subsequent MAP process is actually required, is a valid and pressing question, however. In extreme situations, where it can be convincingly maintained that the Company C – Company B transaction deprives Country B of revenue, perhaps a subsequent MAP process would be appropriate and required.

If a triangular case would exist (which is a major if), there are several possibilities to address the issue presented for Country B either (i) simultaneously with the review of the Country A – Country B transaction, (ii) subsequently, or (iii) prospectively (by way of an APA) and (iv) even in some form of multilateral fashion, without having to resort to complicated measures. Those solutions all require compliance with the applicable procedural rules, however, and require all parties to be interested in constructively resolving the issue.

The mere feat that the Arbitration Convention is currently in effect is in and of itself already a major achievement in the world of international tax. We should therefore very carefully consider whether practical inconveniences can be addressed with nothing more than practical solutions and refrain as much as possible from tinkering with the (workings of) the Arbitration Convention: "If it aint broke, why fix it?"