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# **EU JOINT TRANSFER PRICING FORUM**

## **REPORT ON NON EU TRIANGULAR CASES**

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## **I. Preamble**

In accordance with the discussion held at the JTPF in its meetings of October, 23<sup>rd</sup>, 2007 and February 21<sup>st</sup>, 2008 a sub-group was asked to discuss further the triangular transfer pricing cases. The sub-group met in Brussels on 15 January 2008, 29<sup>th</sup> April 2008, 8<sup>th</sup> July, 2008 and 23<sup>rd</sup> January 2009.

The present report is based on the work of the sub-group as reported in the plenary meeting of March 2009.

This JTPF report provides some non prescriptive suggestions regarding dispute resolution relating to transfer pricing cases in the case of non EU triangular transfer pricing, as hereafter defined, without any prejudice to whether or not such cases may be covered in part or whole by the EU Arbitration Convention.

It is neither the intention that Competent Authorities activity in Non EU Triangular cases would provide any greater certainty than for EU triangular cases nor that the Non EU definition denies access to the Arbitration Convention only because a non EU state is involved.

## **II. Definition of triangular cases (in the context of MAP)**

To assist in focusing the JTPF discussion it was suggested to adopt a definition on triangular cases which is intended to be neither too broad nor too narrow. This adopted definition duplicates the one included in the report on EU triangular cases.

For the purpose of this document a triangular case is a case where two states in a MAP cannot fully resolve any double taxation arising in a transfer pricing case when applying the ALP because an associated enterprise [as defined in the Arbitration Convention] situated in a Third State and identified by both EU CAs (evidential based on the comparability analysis including a functional analysis and other factual elements) had a significant influence in contributing to a non arm's length result in a chain of relevant transactions or commercial / financial relations and recognised as such by the taxpayer suffering the double taxation and requesting the MAP.

Two types of cases can be distinguished:

- cases where all associated companies concerned are situated within the EU (hereafter referred to as EU triangular cases);
- cases where the associated company identified as being the source of non arm's length results in a chain of relevant transactions or commercial / financial relations is situated outside the EU (hereafter referred to as non-EU triangular cases).

Where there is a transaction involving a non EU third State, EU taxpayers should – as far as possible – enjoy the same treatment as for transactions involving only EU Member States. On the other hand, the protection offered should not exceed that level.<sup>1</sup>

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<sup>1</sup> **German reservation on this paragraph:**

With regard to this sentence Germany holds the view that in a non EU triangular case the taxpayer can only enjoy the same treatment as for transactions involving only EU Member States if the treatment concerning all enterprises involved complies with the arm's length principle. Germany is of the opinion that the aim of the arbitration convention is to eliminate double taxation according to the

### **III. . Potential approaches to non EU triangular cases**

#### **3.1 Treaty Network**

##### *3.1.1 Improvement and extension of the treaty network*

In the absence of a DTA or where a DTA does not contain a MAP provision, there is no clear process to facilitate the elimination of double tax. To remedy this situation an extensive network of treaties between both EU Member States and non EU Member States, which contain an effective MAP Article, is considered vital.

##### *3.1.2 Inclusion of Article 25 (5) of the OECD MTC*

The MAP procedure in most current DTAs does not *require* the Competent Authorities to reach an agreement that eliminates the double taxation but only that they use best *endeavours* to resolve the case. Where, after applying best endeavours, Competent Authorities cannot agree unrelieved double taxation or taxation not in accordance with the tax treaty may result. This situation is a major source of concern for taxpayers and CAs. Recent developments in the work of OECD on Article 25(5) of the MTC provide the option of mandatory arbitration.

According to paragraph 64 of the OECD Commentary to this provision, paragraph 5 of Article 25 "*...is [therefore] an extension of the mutual agreement procedure that serves to enhance the effectiveness of that procedure by ensuring that where the competent authorities cannot reach an agreement on one or more issues that prevent the resolution of a case, a resolution of the case will still be possible by submitting those issues to arbitration ...*".

Therefore, as far as bilateral DTAs will include such a clause, the effectiveness of MAP will be strengthened.

It would be also helpful if EU Member States were able to indicate whether or not in negotiating or reviewing their tax treaties, they will propose to include article 25(5) of the OECD MTC.

Some practical aspects of the inclusion of the new Article 25(5) were also discussed. It was considered that in applying article 25(5) of the OECD MTC in bilateral tax treaties Competent Authorities could face implementation difficulties in the absence of clear rules (e.g. how to set up an advisory commission, how to select the members, how to share the costs, language to be used, how to select a point in the range, etc.). This could lead to very long procedures including the risk of ultimately stepping out of the art. 25.5 arbitration process. However the model mode of application ("sample mutual agreement on arbitration") which is included as an annex to the OECD's update of the Commentary to Article 25 might be useful in this respect.

#### **3.2. A Case by Case approach to resolution**

The following routes to resolution are put forward but it is emphasised that the facts and circumstances of particular cases will finally determine if a proposed solution is appropriate.

##### *3.2.1 Resolution of the issue prospectively: Advance Pricing Agreements*

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arm's length principle. Therefore any application of the arbitration convention must conform to the arm's length principle

One approach may be to enter into an APA relating to the transactions in order to avoid the issue arising for prospective years. Moreover by concluding an APA, CA's could agree to apply the outcome of the APA to previous years covered by the pending MAP procedures through an official or informal agreement taking into consideration the possibilities allowed under domestic law.

On the issue of potential roll back, the subgroup referred to point 8.3 of the Guidelines for APA's in the EU, included as an annex to the Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU (COM (2007) 71 final) of 26 February 2007 that reads:

**“8.3. Rollback**

*58. Rollback – when provided for in domestic legislation –can be considered where it will resolve disputes or remove the possibility of disputes in earlier periods.*

*59. Rollback should only be a secondary result of the APA and should only be carried out where it is appropriate to the facts of the case. Similar facts and circumstances to those in the APA should have existed for previous periods in order for rollback to be appropriate.*

*60. Rollback of the APA should only be applied with the taxpayer's consent.*

*61. A tax administration has recourse to the usual domestic measures if, as part of the APA process, it discovers information which would affect the taxation of earlier periods. But tax administrations should advise the taxpayer of any such intended action to give the taxpayer the opportunity of explaining any apparent inconsistency before making a tax re-assessment concerning previous periods.”*

For further consideration see paragraph 77 of APA report

**3.2.2 Article 25 (3) of the OECD MTC**

Article 25(3) of the OECD MTC, where incorporated in the relevant treaties between the parties, might be interpreted such that it extends the scope of Art 25 to solve disputes relating to transfer pricing adjustment in the case of non EU triangular transfer pricing cases and provides the option of a tri-lateral approach to eliminating that double tax. However not all DTC`s follow the language of the MTC to facilitate this interpretation.

In those cases a possibility could be the conclusion of a separate and specific (bilateral/multilateral) protocol / (additional) convention to solve such cases. However, the approval of this protocol / (additional) convention might necessitate adoption through the legislative chambers – which might take considerable time.

**3.2.3 Extension of the AC to a third State**

It may be worthwhile exploring on a case by case basis whether the provisions of the AC can be extended to a Third State, based upon Articles 35 and 36 of the Vienna Convention on

the law of treaties<sup>2</sup> assuming acceptance of such rights or obligations by the Third State. CA's may wish to consider using this instrument to involve the third country in the proceedings as well. This extension would only bind the CAs involved in the specific case.

Articles 35 and 36 of Vienna Convention on the law of treaties read:

*“Article 35: 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: Treaties providing for rights for third States*

*1. 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.*

*2. A State exercising a right in accordance with paragraph 1 shall comply with the conditions for its exercise provided for in the treaty or established in conformity with the treaty.”*

### 3.3. Procedural considerations

#### *3.3.1 The role of the taxpayer*

The JTPF recognises the key role of the taxpayer in non EU triangular cases.

Although the MAP is in essence a procedure between tax administrations, in view of the specific nature of the triangular cases, more involvement of the taxpayers in the MAP could be envisaged for example by providing additional information requested and points of factual clarification.

In this context it must also be added that it is primarily for the taxpayer to identify the commercial/financial relationship(s) resulting in double taxation. The taxpayer needs to provide a comprehensive analysis of all relevant facts and present evidenced based reasons as to which contracting States should start the appropriate procedure. Adoption of the EUTPD-concept might be quite helpful in this respect.

As soon as possible the taxpayer should inform the CAs that (an)other party(ies) in (a) third non EU MS(s) is(are) involved. Indeed without such information the resolution of the case could be impossible due to the different deadlines. It is in the interest of both tax administrations and taxpayer(s) that a co-operative position is taken to achieve swift resolution. This implies the timely exchange of information and delivery of documentation by all stakeholders (including the tax administrations).

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<sup>2</sup> The Convention was adopted on 22 May 1969 and opened for signature on 23 May 1969 by the *United Nations Conference on the Law of Treaties*. The Conference was convened pursuant to General Assembly resolutions 2166 (XXI) of 5 December 1966 and 2287 (XXII) of 6 December 1967. The Conference held two sessions, both at the Neue Hofburg in Vienna, the first session from 26 March to 24 May 1968 and the second session from 9 April to 22 May 1969. In addition to the Convention, the Conference adopted the Final Act and certain declarations and resolutions, which are annexed to that Act. Entry into force on 27 January 1980, in accordance with Article 84(1). Official Publication in United Nations, *Treaty Series*, vol. 1155, p.331.

### *3.3.2 Coordinated actions between EU CAs*

In an identified non-EU triangular case the participation of non EU Competent Authorities participation is crucial to eliminate double taxation. The EU competent authorities should agree how to discuss the case and who is best placed to make initial contact with the appropriate non-EU Competent Authority, in order to instigate a procedure to implement efficiently the MAP process.

### *3.3.3 Extension of the two-year term*

Where appropriate, to give enough time to the CA's involved to reach an adequate and acceptable solution invoking paragraph 4 of Article 7 may be considered, i.e., 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 extended. If 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 extension. That way, the taxpayer's rights would be safeguarded and the tax authorities would be able to pursue an equitable resolution although taking more time than usual under Article 7 of the AC.

## **IV. Conclusion**

The JTPF believes that, in the light of practical experience to date, it has taken the discussion as far as it is possible. However future developments, as countries and businesses gain more experience in the subject, may bring the item back on the JTPF work programme.