



EUROPEAN COMMISSION

DIRECTORATE-GENERAL

TAXATION AND CUSTOMS UNION

Direct taxation, Tax Coordination, Economic Analysis and Evaluation

Company Taxation Initiatives

Brussels, May 2013

Taxud/D1/

DOC: JTPF/011/2013/EN

EU JOINT TRANSFER PRICING FORUM

Discussion paper on the improvement of the functioning of the Arbitration Convention

Meeting of 6 June 2013

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A. Background

1. In accordance with the work programme of the EU Joint Transfer Pricing Forum (JTPF) for 2011-2015 previous achievements are monitored with the aim to establish to what extent earlier work of the JTPF is implemented, to evaluate its effectiveness and to consider how improvements might be made.
2. At its meeting on 25 October 2012 the JTPF formally agreed to start the monitoring of the functioning of the Arbitration Convention (AC) and the revised Code of Conduct (CoC) in 2013, as per the calendar in document JTPF/018/2012/EN ("Monitoring Overview and Proposals").
3. With respect to the functioning of the AC and its CoC feedback was collected from JTPF members and from members of advisory commissions.
4. The present discussion paper reflects the comments received from JTPF members. Comments by members of advisory commissions are included in a separate document (doc. JTPF/010/2013) and will also inform the discussion on the improvement of the functioning of the AC and its CoC.
5. Initial comments by JTPF members on the improvement of the functioning of the AC and its CoC were collected in 2012. These are included in document JTPF/020/REV1/2012/EN. Member States (MS) also carried out a qualitative analysis of their pending cases to find out the concrete reasons why cases have lasted more than two years. The responses are summarised in document JTPF/003/2013/EN.
6. On the basis of contributions received the Secretariat prepared a Discussion paper on ways to improve the functioning of the Arbitration Convention (JTPF/002/2013/EN) for the JTPF meeting on 14 February 2013. At the meeting, JTPF members agreed to divide the issues identified in the discussion paper in three categories: issues on which draft recommendations should be agreed, issues on which further work is foreseeable but which would require in-depth discussions and issues on which no further work is necessary at this stage (see summary record, doc. JTPF/005/2013/EN). Following the meeting MS were asked to clarify some additional issues listed in document JTPF/002/2013/EN and/or identified during the discussions.
7. The present discussion paper aims to structure future work on the improvement of the functioning of the AC and its CoC. It contains a work plan which sets out the issues which the JTPF has decided to address further (section B). These are divided into three sub-categories, according to the point in time when they will be taken up by the JTPF (short/mid/long term). The short-term issues will be discussed at the JTPF meeting in June 2013 and concern possible recommendations in the CoC (section C). Those issues where further input from JTPF members is necessary are regarded as mid-term issues. Section D provides an overview on the current state of play. The long-term issues, not addressed in this discussion paper, represent items which require a broader discussion. These issues are only listed in this discussion paper for further consideration (section E).

B. Work plan

Overview on items to be addressed in the context of monitoring the AC (numbering as per doc JTPF/002/2013/EN)

June 2013 Short-term issues	November 2013 Mid-term issues	2014/2015 Long-term issues	Issues not taken up
1.4 Q2 Flexible interpretation of time limits	1.4 Q1 and 1.9: Denying access to AC	2.3 Cases not 'ripe' for the AC	1.4 Q3 and Q4
1.8 Implications of MAP result for other years	2.1 Webpage with MS information on MAP	2.6 Information submitted in MAP but not in audit	1.5
2.4 MAP request to both CAs	2.5 Guidance on multilateral MAP (OECD)	2.13 Informing taxpayer during MAP	1.6
2.8 independence of CA from audit	2.11 MS practices on suspension of tax collection	3.1 Information not sufficient for MAP	1.7
2.10 no waiver of rights for audit settlement	4. Evaluation 2 nd phase from members of advisory commissions	3.2 Guidance on position papers	2.2
	5. Request on serious penalties	3.4 Cancelling MAP	2.7
	8. AC and arbitration under DTA	6. Implication of new Art. 7 OECD MTC	2.9
		7. Change to baseball arbitration	2.12
			3.3

C. Recommendations for the Code of Conduct (short-term issues)

1. Flexible interpretation of time limits (item 1.4, Q 2 doc JTPF/002/2013/EN)

8. With respect to time limits, Best Practice No. 9 of the OECD MEMAP advocates for a flexible approach giving the taxpayer the benefit of the doubt in borderline cases. The JTPF considered that this item should not have a high priority but may be taken up.

For discussion:

The JTPF may discuss a recommendation along the following lines (based on MEMAP): *Balancing a tax administration's need for reasonable time limits with the necessity of providing MAP assistance to those entitled to benefits from the Arbitration Convention can be a difficult issue. Keeping in mind the spirit and objectives of the Arbitration Convention, however, taxpayers should not be unduly prevented from obtaining assistance via MAP due to overly strict interpretations of the Arbitration Convention's time limitation for requesting MAP. Simply put, taxpayers should receive the benefit of the doubt in borderline cases.*

While the onus for making a timely request in order to preserve access to the MAP rests with the taxpayer and taxpayers should take all reasonable steps to ensure that time limits do not expire, it would be helpful for a tax administration making an adjustment to advise the taxpayer of their rights under the Arbitration Convention, including information about any time limits in the Convention for initiating MAP. This written notice or advice could be included at the time of formal notification of a proposed adjustment and could include general guidance on the availability of MAP and how to go about protecting the availability of access to this mechanism. Some tax administrations have implemented the practice of advising taxpayers of both their domestic and convention rights and obligations at the time of the proposed adjustment, with successful feedback and results.

Do you agree with this recommendation which could then be added after the first paragraph in number 4 of the CoC?

2. Implications of MAP results for other years (item 1.8, doc JTPF/002/2013/EN)

9. The following questions were raised and the JTPF concluded that the item should be explored further.
 - Should a simplified MAP be applied for adjustments or assessments of transactions in the period after the years covered by the initial MAP/adjustment when the facts are similar to the ones being subject to the initial MAP?

- Should issues already covered by a MAP in future periods be regarded as low risk areas for purposes of risk management, provided the facts and circumstances are unchanged?

10. Audit procedures and adjustments relate to certain limited tax periods. In cases where a dispute arises (e.g. which functions or risks are assumed, which is the most appropriate method etc.) both sides often stick to their positions until a final decision is reached (through MAP or court decision) and new audit/tax adjustments are made for years not covered by the initial MAP. This then results in further MAP requests. It might be worthwhile for CAs to consider a simplified procedure for MAP requests which are linked to a former MAP.

11. A further aspect that may be considered relates to the implications a MAP agreement may have for future tax periods in general. Provided the facts and circumstances are the same as in the period covered by a MAP decision and the taxpayer follows what has been agreed, the respective items may be regarded as low risk areas and the task of a reviewer would be limited to the evaluation whether the facts and circumstances are still the same as in the period covered by the earlier MAP.

For discussion:

The JTPF may discuss a recommendation along the following lines:

CAs are recommended to apply a simplified procedure for MAP requests linked to issues which are already covered by an ongoing MAP. This simplified approach might consist of adding the new MAP request in the ongoing MAP procedure or to apply immediately the initial MAP outcomes to the new request.

Where appropriate, taxpayers may initiate an APA procedure after the adjustment (if possible with a 'rollback' for earlier tax periods).

If the facts and circumstances in future tax periods are the same as in the period covered by a MAP decision and the taxpayer follows what has been agreed, the respective items may be regarded as low risk areas and the task of a reviewer would be limited to the evaluation whether the facts and circumstances are still the same as in the period covered by the earlier MAP.

Do you agree with this recommendation which could then be added after 6.1 (b) of the CoC?

3. MAP requests to both CAs (item 2.4, doc JTPF/002/2013/EN)

12. JTPF members considered that it would be helpful if both CAs involved are informed by the taxpayer about a MAP request under the AC.

For discussion:

The JTPF may discuss a recommendation along the following lines:

Taxpayers are recommended to submit a copy of their request for MAP under the AC to the other CA involved at the same time and with the same set of information as to the CA to which the request is addressed in accordance with Article 6 (1) of the AC. Where appropriate and allowed, it might be done through electronic means. The fact that a copy of the request was submitted by the taxpayer does not replace the obligation of the CA to inform the other CA about receiving the request under 6.3 (d).

Do you agree with this recommendation which could be added after paragraph 6.3 (d) of the CoC?

4. Independence of CA from audit (item 2.8, doc JTPF/002/2013/EN)

13. It was suggested to ensure that CAs can decide independently from field auditors. The JTPF considered that the item should be addressed in line with the MEMAP recommendation, but adapted to the specific structure of some MS.
14. Best Practice No. 23 of the OECD MEMAP recommends that in order to enhance the independence of a subsequent review of a case by a competent authority, it is recommended that CAs maintain a level of autonomy from the audit function of a tax administration.

Best Practice N°23: Independence and resources of a competent authority

In order to enhance the independence of a subsequent review of a case by a competent authority, it is recommended that competent authorities maintain a level of autonomy from the audit function of a tax administration. In some cases, the competent authorities may take a different approach from audit to explain an outcome or address an issue. This may be a valid exercise, especially for a transfer pricing case and should not necessarily be considered as “redoing the audit”. For example, if a case is without merit and not well substantiated at the audit stage, the competent authority of the state that initiated the adjustment should provide unilateral relief by withdrawing the adjustment without engaging the other competent authority. The guiding principle should be that the competent authority’s function is to ensure a fair and appropriate application of the convention, not to seek to uphold all adjustments proposed by the tax authorities of its country.

Independent and sufficient funding will also enhance the competent authorities' autonomy and enable it to carry out its mandate without becoming overly reliant upon other areas of a tax administration which do not share the competent authorities' primary objective, namely relieving double taxation. Tax administrations should ensure that the competent authority function is given sufficient resources, including qualified personnel, funding, training, and other program needs, to be able to carry out MAP responsibilities in a timely, effective, and efficient manner.

For discussion:

The JTPF may discuss a recommendation along the following lines:

In order to ensure the independence of a subsequent review of a case by a competent authority, it is recommended that competent authorities maintain - as far as possible - a level of autonomy from the audit function of a tax administration. The guiding principle should be that the competent authority's function is to ensure a fair and appropriate application of the AC, not to seek to uphold all adjustments proposed by the tax authorities of its country.

Do you agree with this recommendation which could be added after paragraph 6.1 (a) of the CoC?

5. No waiver of rights for audit settlement (item 2.10, doc JTPF/002/2013/EN)

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

16. The JTPF considered that the issue should be explored further and that a recommendation along the lines of Best practice No. 19 of the MEMAP may be considered.

Best Practice N°19: Avoid blocking MAP access via audit settlements or unilateral APAs

It is a best practice for both taxpayers and tax administrations to avoid the inclusion of a waiver of access to MAP in audit settlements. Since MAP involves bilateral issues it is inappropriate to have two parties (the taxpayer and one tax administration) not include a third involved party (the other tax administration) in the final resolution of a file.

First of all, taxpayers may not realize the potential implications of double taxation and the fact that an adjustment by the other tax administration may complicate the issue. Secondly, tax administrations should consider the issues of cooperation and

reciprocity as well as the fact that one-sided settlements will not serve tax administrations well in the long run.

As for unilateral APAs, if a foreign adjustment is raised against a transaction or issue covered by a unilateral APA, the unilateral APA should be treated as the taxpayer's filing and therefore eligible for MAP and adjustable, as opposed to an irreversible settlement.

For discussion:

The JTPF may discuss a recommendation along the lines of the MEMAP.

Do you agree with issuing a recommendation which could then be added after paragraph 6.1 (a) of the CoC?

D. Update on mid-term issues

1. Rejection of cases (*items 1.4 Q1 and 1.9, doc JTPF/002/2013/EN*)

17. Table 3 of the AC questionnaire for 2012 asks MS for information on reasons why cases were rejected from the AC. The discussion of this item is therefore postponed until responses to the Questionnaire have been received from all MS.

2. Webpage with MS information on MAP (*item 2.1, doc JTPF/002/2013/EN*)

18. At its meeting in June 2012 the JTPF saw a benefit in publishing on the Commission website the country specific information already available on the OECD website which would then be supplemented with the respective information from MS which are not members of the OECD. MS will be invited by the Secretariat to provide/review/update the relevant information.

3. Guidance on multilateral MAP (OECD) (*item 2.5, doc JTPF/002/2013/EN*)

19. The OECD is currently working on multilateral approaches in the context of MAP. This work started on the basis of the JTPF conclusions on triangular cases. Further work on this issue will be postponed until first results of the project from the OECD are publicly available. Based on this outcome it will be discussed whether and how this item should be taken forward by the JTPF, i.e. in this project or in the context of monitoring the guidance on non-triangular cases.

4. MS practices on suspension of tax collection (item 2.11, doc JTPF/002/2013/EN)

20. MS were invited to comment on their practices. As only 10 MS have replied so far, those MS which have not yet responded are kindly invited to do so **by 31 July 2013**.
21. It was stressed that there is a clear need for better information to taxpayers during the MAP procedure and the JTPF concluded to explore this item further
22. Point 6.3 (b), (f) and (g) CoC already states that taxpayers will be informed about all developments, whether the case is considered as being well founded and whether it the request is made within the time limits foreseen under the AC and about the starting point of the two year period.

For discussion:

Based on your experience from applying point 6.3 (b), (f) and (g) of the CoC, may a recommendation or more guidance be provided on ways to inform the taxpayer?

5. Evaluation of 2nd phase by members of advisory commissions (item 4, doc JTPF/002/2013/EN)

23. The comments received from three chairpersons and one member of advisory commissions are included in a separate document (doc JTPF/010/2013/EN). A discussion with the one chairperson and one member will take place at the JTPF meeting on 6 June 2013.

6. Request on serious penalties (item 5, doc JTPF/002/2013/EN)

24. MS were invited to comment on their practices. As only 10 MS have replied so far, those MS which have not yet responded are kindly invited to do so **by 31 July 2013**.

7. AC and Arbitration under Double Taxation Agreements

(item 8, doc JTPF/002/2013/EN)

25. MS were invited to comment on their practices. As only 10 MS have replied so far, those MS which have not yet responded are kindly invited to do so **by 31 July 2013**.

E. Long-term issues (follow up in 2014 -2015)

1. Cases not yet 'ripe' for the AC (item 2.3 doc JTPF/002/2013/EN)

2. Information submitted in MAP, but not in audit (item 2.6 doc JTPF/002/2013/EN)

3. Informing taxpayer during MAP (item 2.13 doc JTPF/002/2013/EN)

4. Information not sufficient for MAP (item 3.1 doc JTPF/002/2013/EN)

5. Guidance on position papers (item 3.2 doc JTPF/002/2013/EN)

6. Cancelling MAP (item 3.4 doc JTPF/002/2013/EN)

7. Implication of new Art. 7 OECD MTC (item 6. doc JTPF/002/2013/EN)

8. Change to baseball arbitration (item 7 doc JTPF/002/2013/EN)