EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
TAX POLICY
Coordination of tax matters

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Taxud/C1/WB/LDH

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SUMMARY RECORD OF THE SIXTH MEETING OF THE EU JOINT TRANSFER PRICING FORUM

held in Brussels on 18th March 2004

I ADOPTION OF THE AGENDA (DOC JTPF/001/2004/EN/FR/DE)

1. The proposed agenda was adopted by consensus.

II ADOPTION OF THE SUMMARY RECORD OF THE JTPF MEETING OF 11TH DECEMBER 2003 (DOC JTPF/002/2004/EN)

2. The Observer from the OECD suggested changing the wording of paras. 23 and 43 and a Tax Administration Member proposed an amendment to para. 33. With these changes the summary record was adopted by consensus.

III ORAL REPORT FROM TAX ADMINISTRATION MEMBERS ON THE RATIFICATION PROCESS

3. Members from the relevant tax administrations reported on the state of play of the ratification of the Prolongation Protocol and the Convention concerning the accession of Austria, Finland and Sweden to the Arbitration Convention.

4. The *Italian* Tax Administration Member informed the FORUM that the Prolongation Protocol had been approved by the Lower House of Parliament and that it was hoped that it would be ratified soon.

5. The Member from the tax administration of *Portugal* indicated that the draft bill pertaining to the Prolongation Protocol had been introduced in Parliament and that it was hoped that the Prolongation Protocol would be ratified before July 2004.

6. The Member from the *Greek* tax administration informed the FORUM that contrary to the information given at the meeting on 11th September 2003 her country had not yet ratified the Convention concerning the accession of Austria, Finland and Sweden to the Arbitration Convention. She added that the ratification process would still take some time because of recent Parliamentary elections.

7. The *Chair* concluded that some progress on the ratification process had been made and that those countries which had not yet ratified the Prolongation Protocol or the Accession Convention should provide a progress report at each meeting of the FORUM. Considering that the Accession Convention had been signed in 1995, he expressed his disappointment, however, that *Greece* had not yet ratified that instrument.

IV ORAL REPORT FROM THE COMMISSION ON THE STATE OF PLAY OF THE FORUM'S FIRST REPORT

8. The Secretariat reported that following an observation from the Commission's legal service that the Commission had the sole right of initiative, it was up to the Commission and not to the JTPF to propose a Code of Conduct to the Council. It was, therefore, agreed to change the wording of the draft Communication to the Council to this effect. In this context the Secretariat remarked that the Commission's Communication to the Council would not mention the position of individual Member States. Member States could, however, give notice of their concerns or reservations in the Council.

9. In addition, the Commission's legal service considered a Code of Conduct to be an unorthodox measure and not an instrument of Community law. The appropriate form would rather be a Council Recommendation based on Article 94 EC, which would, however, entail the additional procedural requirement of consultation of the European Parliament.

10. There was some discussion on the extent to which a Council Recommendation and a Code of Conduct were legally binding and what effect this might have in relation to the European Court of Justice. A Member from business stated that although a Council Recommendation was not legally binding in the strict sense, all Member States had acknowledged the recommendation and – refering to the "Grimaldi case" – it was therefore binding in some form.

11. The *Chair* concluded that it was most important to finalise the formal procedure and make the FORUM'S proposal public as soon as possible. The Secretariat added that the Commission in its Communication to the Council could only make a proposal for a Code of Conduct or Recommendation but it was up to the Council to decide on the final legal form.

12. The Secretariat added that the draft Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee containing in the annexes the proposal for a Code of Conduct for the effective implementation of the Arbitration Convention and the report on the work of the EU Joint Transfer Pricing Forum from October 2002 to December 2003 was expected to be adopted by the Commission in April 2004 at the latest. The Commission's inter-service consultation was coming to a close with a few additional drafting suggestions made by the legal service, which the FORUM adopted by consensus. The Secretariat explained that the Commission's Communication probably would be submitted first to the Council's Working Party on tax questions. The Code

of Conduct was then to be adopted by the ECOFIN Council and implemented by all Member States. The FORUM took note of the Secretariat's explanations concerning these procedures.

V DISCUSSION ON THE WORK PROGRAM (DOC JTPF/008/2004/EN)

13. Emphasizing that the FORUM was a Commission working group, the Secretariat explained that the Commission would announce in its Communication to the Council, transmitting the FORUM'S report on its activities from October 2002 to December 2003, to extend until the end of 2004 the FORUM'S mandate. Taking into account the overall results and further issues for discussion identified and proposed by the FORUM, the Secretariat added that the Commission might decide on a further extension of the FORUM'S mandate for another period of two years.

14. Most Tax Administration Members and Members from business expressed their desire to extend the FORUM'S mandate beyond the end of 2004. The majority of Members took the view that the FORUM should try to complete its work on the issue of documentation requirements by the end of 2004 and, therefore, should not discuss an additional issue until then. The *Chair* supported this view stressing that it was desirable to achieve a tangible result on documentation requirements before addressing new issues. The FORUM agreed, therefore, by consensus to discuss only documentation requirements at its meetings in June and September 2004 and if necessary in December 2004.

15. The FORUM noted that Business Members intended to submit two documents for the June 2004 meeting on possible issues for future discussions: (i) a paper on transfer pricing issues that were important but had not yet been discussed and (ii) a paper on penalties in relation to non-compliance with documentation requirements and in relation to transfer pricing adjustments.

16. Some Members from tax administrations said that they were not in a position to decide on the prolongation of the FORUM'S mandate beyond 2004 before the possible work program had been proposed. The Member from the *UK* tax administration stated his country could take a position only after the Commission Communication had been issued.

17. The FORUM agreed by consensus to discuss at the June 2004 meeting a possible work program including the question whether the new work program should contain only issues carried over from the FORUM'S original work program for 2002 to 2004, i.e. (i) examination of possible preventive measures to avoid double taxation and (ii) acceptability of transfer prices to tax administrations; or include other issues as well.

18. The *Chair* stated that a decision on the extension of the FORUM'S mandate should be taken after the meeting in June 2004 in the light of the results that could be achieved until the end of 2004 and further issues for discussion identified and proposed. He added that it was finally up to the Commission to decide on the extension of the FORUM'S mandate. Member States could, however, decide not to participate in the FORUM'S work.

VI DISCUSSION ON DOCUMENTATION REQUIREMENTS

a) Draft revised discussion paper on documentation requirements (doc. JTPF/019/REV1/2003/EN)

19. The Secretariat gave an overview of the document highlighting the changes made to the previous version, notably the inclusion of the summary of pros and cons of the different documentation concepts. The *Chair* added that the discussion paper was an evolving document that should be seen as a framework for a future report of the FORUM.

20. Some Tax Administration Members expressed concern about the implications that the document might have on their legislation and administrative practice and requested that the title be changed to make clear that it was a discussion paper from the Secretariat.

21. The majority of Members from tax administrations considered the reference to ECJ decisions in para. 8 inappropriate and also proposed to delete para. 89 d).

22. The Observer from the OECD commented on paras 83 and 84 by clarifying that para. 1.42 of the OECD Transfer Pricing Guidelines solely addressed the possible aggregation of a taxpayer's own transactions where these transactions were interrelated and that this paragraph was not concerned with the question of whether third party data aggregated on a company-wide basis could be used for practical reasons in a comparability analysis.

23. With reference to para. 96 a Member from business claimed that a taxpayer who had complied with documentation requirements should be subjected neither to documentation related penalties nor to serious penalties in the meaning of Article 8 of the Arbitration Convention denying him access to dispute resolution procedures.

24. The proposed changes as mentioned above and some additional minor drafting suggestions were adopted by consensus.

b) Draft working paper on database searches for comparables (doc. JTPF/0005/2004/EN)

25. The Secretariat introduced the document stressing that database searches for comparables were of particular relevance when using the TNMM method. This method was, however, to be used only when traditional transaction methods could not be reliably applied alone or exceptionally could not be applied at all. Profit methods in general should be considered as methods of last resort.

26. A Tax Administration Member noted that the companies who maintained pan-European databases were not the same companies as those who maintained country-specific or regional databases, and the data used were also different. The results of pan-European database searches might, therefore, not always correspond to the results of country-specific or regional databases.

27. Members from business stressed, however, that in 95 % of the cases pan-European arm's length ranges did not statistically differ from country-specific arm's length ranges, i.e. they generated results supporting the equality of inter-quartile ranges. In the remaining 5% of the cases there was no obvious bias or pattern of profit levels indicating that a particular European country's arm's length range of results or the range of results in a particular

industry were always statistically different from the rest of Europe or from other industries. Business Members added that the issue was not comparability, because it was assumed that the data used were comparable and that the taxpayer had demonstrated that traditional transfer pricing methods were not applicable.

28. *Dr. Kroppen* explained that his contribution (the Deloitte White Paper doc. JTPF/007/BACK/2004/EN) was based on a scientific research of three economists who had conducted 234 statistical tests covering 9 industries in 16 European countries. The aim of the research was not to promote a specific transfer pricing method. Rather, the research was based on the assumption that the conditions for exceptionally applying the TNMM method as set out in the OECD Transfer Pricing Guidelines were met. He added that the results of the research lent itself to the conclusion that country-specific database searches for comparables within the EU, which could theoretically amount to 25 different database searches entailing considerable expenses for companies, were not justifiable. Taxpayers should, therefore, not be subjected to documentation related penalties for not having used a country-specific database search.

29. The *Chair* noted that the results of the research showed that significant reductions in compliance costs related to comparable searches seemed possible if the quality of the information provided by the taxpayer was sufficiently precise and reliable.

30. One Tax Administration Member highlighted the relation between risk assessment and the search for comparables. He stated that the decisive question was not whether or not a country-specific or pan-European database search was used. The decisive question was rather whether the comparables presented by the taxpayer were appropriate and really comparable with the taxpayer's own transactions. Tax administrations should, however, not expect businesses to make excessive effort in finding comparables by sophisticated and costly means if the tax as risk was rather low. He cautioned that while there were circumstances where pan-European comparables might be comparable, they were not necessarily comparable in all cases.

31. Another Member from a tax administration argued that in practice the quality of data from databases were often insufficient. In addition, database results were related to profit indicators and were not transaction-based. However, in principle, adjustments to arrive at transaction-based results were possible, albeit at significant expense. He also indicated that in some Member States many companies did not make their financial data available to databases.

32. Some Tax Administration Members were concerned that the adoption of a document by the FORUM allowing for the use of pan-European database searches for comparables might lead to a wide-spread use of profit methods like in the USA.

33. A business Member recalled that the purpose of the FORUM was to find pragmatic solutions. In this context it should be noted that a business performing simple functions might require the aggregation of transactions and database searches for comparables in an effort to avoid penalties. The question was what standards were necessary for database searches to be acceptable to tax administrations.

34. A Member from a tax administration replied that pan-European database searches were acceptable if the tested companies and functions were comparable and if the company under

examination performed only simple transactions. Complex functions and transactions, on the other hand, required segmentation. As segmentation was often not possible, the scope of application of database searches was rather limited. Furthermore, the Supreme Tax Court of Germany had ruled that tax administrations were not allowed to use databases for transfer pricing adjustments as this would result in a minimum taxation. This Member argued that for the German tax administration it was unacceptable that database searches could only be used by companies to justify their transfer pricing but not by the tax administration to justify transfer pricing adjustments.

35. Another Tax Administration Member commented that the TNMM method could be used with means other than commercial database searches. This Member also did not support the idea of looking at profit segments.

36. On the question of what impact the accession of ten new Member States might have on the results of the Deloitte White Paper, a Business Member replied that the influence was rather limited for the time being because their markets were in most cases still too different from the markets in the existing 15 Member States and, therefore, could not be included in such a database research. The results of the Deloitte White Paper would only be affected over time in the process of all EU markets growing together to one internal market.

37. This business Member stated that being mindful that databases were not perfect, they indicated, in any case, whether a company's transfer prices fall within the arm's length range. Database searches were useful for simple transactions and simple functions, e.g. contract manufacturing and distribution. By contrast, they were inapplicable for most parent companies, because of the uncertainties concerning the value of a parent companies' intangibles, e.g. tradenames. He remarked that the Deloitte White Paper did not make a statement whether or not the TNMM method was to be preferred over the profit split method.

38. A Member from a tax administration cautioned that database results did not allow to identify the profits from specific transactions as provided for by the TNMM method when used in compliance with the OECD Transfer Pricing Guidelines. FORUM Members should, therefore, agree to perform vigorous analyses on a case by case basis to achieve comparability.

39. Several Members from tax administrations supported the view that the question whether pan-European database searches were acceptable could not be answered in principle but only on a case-by-case basis taking into account the facts and circumstances of the case including the comparability analysis. They stressed that the decisive issue was not the kind of database that the taxpayer used but rather whether or not the quality of the data was sufficient. They also cautioned that taxpayers should not apply the TNMM method simply because database results were available without prior examination of whether traditional transaction methods could be applied.

40. The *Chair* commented that the issue was not whether the use of the TNMM method was appropriate in certain circumstances. The question was rather whether a multinational enterprise could use a pan-European database search instead of a multitude of country-specific database searches.

41. One Tax Administration Member took the position that the use of database searches should be limited to cases where the enterprise under examination performed only one single and at best a simple function and where the comparable companies had a clear structure and performed clearly identifiable functions.

42. The *Chair* commented that this position implied specifying when the TNMM method could be used - an issue that interfered with the work of the OECD and was outside the FORUM'S remit. In summing up the extensive discussion on database searches, the *Chair* concluded that there was consensus that tax administrations should not reject automatically domestic or non-domestic comparables found in pan-European databases but tax administrations should evaluate them with respect to the specific facts and circumstances of the case. Also, the use of pan-European databases should not by itself subject the taxpayer to penalties for non-compliance with documentation requirements.

c) Draft discussion paper on the masterfile concept (doc. JTPF/003/2004/EN)

43. After the Secretariat had given an overview of the document, the *Chair* solicited comments from FORUM Members on the discussion paper.

44. Business Members expressed their preference for a standardised approach. On the issue of centralisation they stated that it should be irrelevant for tax administrations where a taxpayer prepared and stored its documentation as long as the documentation was sufficient and made available to the tax administrations upon request. A centralised approach was not appropriate in all cases. For example, in a decentralised group of companies even associated enterprises in one country might not know much of each other. And a group of companies with a centralised structure might have decentralised its documentation.

45. The discussion revealed that there was consensus among FORUM Members that standardised and centralised documentation, e.g. the masterfile concept, meant that a multinational group of companies has a standardised set of documentation at company level for all associated enterprises in all countries as opposed to standardisation of documentation at country level for all companies in that country regardless of the industry sector or group to which they belong.

46. Members from tax administration and business stated that one of the main advantages of standardised documentation was the reduced risk of double taxation because all tax administrations had the same information and documentation available. This could also facilitate and expedite mutual agreement procedures. A Tax Administration Member added that it was important for the masterfile concept that transfer pricing methods were applied consistently within a multinational group.

47. Some Tax Administration Members stated that they were not in a position to support the masterfile concept as yet but were willing to explore its potential in more detail. In any case, care had to be taken that tax administrations were legally entitled to have access to the masterfile regardless of where it was prepared and stored. In this context some Members from tax administrations expressed their concern that tax administrations examining a subsidiary might have difficulties to obtain documentation and information prepared and stored by the parent company in a foreign country.

48. A Tax Administration Member commented that in his view applying the masterfile concept implied, for example, that a subsidiary had to prepare documentation on the facts and circumstances of the case, whereas the parent company had to prepare documentation on the arm's length nature of the company's transfer pricing.

49. In the view of Business Members the key question for the Members from tax administrations should be what documents and information should be included in a taxpayer's documentation to allow the tax administration to identify areas where tax is at risk. It should be up to the taxpayer to decide where and in which way documentation was prepared and stored.

50. Another Member from a tax administration described what tax administrations and business might legitimately expect from good and effective documentation: tax administrations wanted to understand the taxpayer's business and its transfer pricing, whereas business was interested in reduced compliance costs and a reduced chance of being exposed to penalties and examination. He added that in his view the masterfile concept should meet these expectations.

51. FORUM Members agreed by consensus that considering the characteristics of certain businesses, the implementation of the masterfile concept should be optional for the taxpayer. Also, the key issue was standardisation of documentation and the degree of flexibility, whereas centralisation was not critical.

52. A business Member remarked that the masterfile concept could only be optional for tax administrations if those countries that did not accept it had no documentation requirements in place. The *Chair* added that the masterfile concept would not be workable if only few countries accepted it.

53. Some Tax Administration Members indicated, however, national legislation might require taxpayers in their countries to prepare additional documentation to what might already be available in a masterfile. This view was contested by a Member from business who also stated that companies that were consistently audited should not be required to submit documentation for case selection purposes when filing their tax return.

54. FORUM Members expressed differing views concerning a list of documents that should be part of the masterfile to protect taxpayers from penalties for non-compliance with documentation requirements. Some Members from tax administrations said that the imposition of penalties in most cases contained an element of judgment and that complete certainty for the taxpayer would require specific legislation. One member from a tax administration requested that the list of documents should also include a company's description of its transfer pricing system or its internal transfer pricing instructions.

55. With reference to item 3.1. c) of the discussion paper Members also expressed differing views on the question if a taxpayer should be required to describe all controlled transactions of the group and how penalties could be justified if the masterfile concept did not require a taxpayer to include a description of all controlled transactions. A Member from a tax administration questioned whether the masterfile should not include comparables. The discussion showed that there was also no consensus on the geographical scope that the items 3.1 a) – e) of the discussion paper should cover.

56. The FORUM agreed by consensus not to include item 3.1 g) of the discussion paper in the list of documents for a masterfile and the *Chair* concluded that list of documents and the issue of geographical scope should be discussed in more detail at the next meeting.

57. A business Member recalled that the main purpose of standardised documentation requirements for business was the avoidance of documentation related penalties. Therefore, if a tax administration requested documents that were not included in the list of documents for a masterfile, the taxpayer should in any case not be subjected to penalties for non-compliance. This did not mean, however, that the tax administration was not allowed to make a transfer pricing adjustment. Another Member from business added that a taxpayer who had complied with the requirements of the masterfile concept should not be denied access to a mutual agreement procedure under the Arbitration Convention or a Double Tax Treaty.

58. On the issue of timing, i.e. when the taxpayer had to make his documentation available to the tax administration, most Members from tax administrations took the position that all documents as provided for in national legislation should be available at the beginning of a tax audit. When filing the tax return, however, only a limited number of documents should be submitted. One Member from a tax administration argued that the FORUM should agree on a list of documents that a taxpayer should be required to make available when filing his tax return. A related issue was whether a tax administration could require a taxpayer during an audit to provide certain supplementary documents and impose penalties in case of non-compliance.

59. On the issue whether Member States could accept a masterfile that was set up in a common language the discussion revealed controversial views. Most Members from tax administrations argued that a masterfile might contain descriptions of complicated issues and that most tax auditors did not have sufficient language skills to understand these in a foreign language.

60. One Tax Administration Member said that the masterfile concept offered business substantial benefits, such as freedom from penalties and a reduction of compliance costs. In return it could be expected that the masterfile documents were translated into the relevant national languages. Another Member from a tax administration suggested that tax administrations should designate one or two foreign languages that were accepted.

61. The *Chair* cautioned that the money saved on tax advisors should not be outweighed by the money spent on translators. Business Members suggested two options: (i) that only a limited number of documents should be translated into the national languages or (ii) the masterfile should be kept in English and translation should be provided only upon request. With reference to question 7 of the discussion paper Business Members stressed, however, that 30 days were not sufficient to translate and submit documents.

62. It was finally agreed by consensus that only a limited number of masterfile documents should be available in the relevant foreign languages from the outset and that translation of all documents should be made available only upon request during a tax audit. The *Chair* asked Tax Administration Members to prepare for the next meeting a list of documents and information that needed to be included in a masterfile. He added that any comments on the masterfile concept should be submitted to the Secretariat by end of April 2004.

VII ANY OTHER BUSINESS

63. It was agreed by consensus that the next JTPF meetings should take place on 10 June, 16 September and 14 December 2004. The meeting on 10 June will start at 9 a.m.