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EU JOINT TRANSFER PRICING FORUM

Improving the 'second phase' of the Arbitration Convention:

Summary of suggestions made by members of advisory commissions

Meeting of 6 June 2013

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In the context of the monitoring of the Arbitration Convention (AC) the JTPF Secretariat asked in March-April 2013 three chairmen and one member of advisory commissions (Dr John Avery Jones CBE, Mr Malcolm Gammie CBE QC, Prof. Dr José Manuel Calderón Carrero and Prof. Sven-Olof Lodin) to provide written feedback on the administrative aspects of the arbitration procedure envisaged under the AC.

The four respondents were asked to comment on whether the respective provisions of the AC and the revised Code of Conduct on the effective implementation of the AC (CoC) provided them with sufficient guidance on the procedure, as well as to make suggestions on improving certain provisions of the AC and the CoC. No confidential information was disclosed during this exercise.

The suggestions raised in the contributions received are summarised below under 7 headings. Neutralised versions of the full texts of the contributions received are included in the annex to this document.

The present summary has been prepared by the JTPF Secretariat with the aim to facilitate the discussion on the 'second phase' of the AC at the JTPF meeting on 6 June with two of the respondents - Mr Malcolm Gammie CBE QC and Prof. Sven-Olof Lodin. The expected outcome of this exercise would be to agree on ways to improve the 'second phase' of the AC.

1. Access to arbitration under the AC

Suggestions:

- Mechanisms (bodies) should be established to enforce the taxpayer´s rights under the AC, so as to preempt situations in which recourse to the AC is blocked by tax administrations with arguments that the case is not suitable for arbitration, or that it falls outside the scope of application of the AC.
- Formal guidance should be provided on what cases could be considered as abusive and therefore outside the scope of application of the AC[1].
- Clarification should be provided on the relationship between domestic procedures and the arbitration procedure, in particular as regards Article 7.3 of the AC.

2. Composition and functioning of advisory commissions

Suggestion:

> Representatives of tax administrations should not be involved in the actual decision of the advisory commission. Their status as full members of an advisory commission, their right to vote on the opinion of the advisory commission and their obligation to sign it impede the efficient functioning of advisory commissions.

[1] The original formulations of the first two suggestions under this heading appear to refer to access to the AC in general (i.e. MAP and arbitration) rather than just to arbitration (the so called 'second phase'). However, as it may occur that access to arbitration as such is delayed or blocked due to administrative problems, we have included these suggestions for further consideration.

3. Content of the arbitration proceedings

Suggestions:

- Formally provide for separate deliberations of the independent members of the advisory commission and Chairman.
- Formally envisage the involvement of the taxpayer (and possibly the concerned auditor) in the procedure as source of relevant information.
- Provide guidance as regards the content and format of information to be supplied by tax administrations in advance to the proceedings.
- Formally envisage the possibility of a majority decision taken only by the independent members of the advisory commission and Chairman.

4. Timing of the arbitration procedure

Suggestion:

As the period of 6 months may prove too short for an advisory commission to deliver an opinion on complex cases, an optional extension to one year should be envisaged for such cases.

5. Remuneration of chairmen and independent members of advisory commissions

Suggestion:

Work outside official meetings (reading written material, exchanging emails, making conference calls, agreeing the wording of the opinion, travelling) should be recognised. Remuneration should be fixed by reference to actual time spent on the case and not on the basis of meeting days.

6. Remit of and follow-up to advisory commissions' deliberations and opinions

Suggestions:

- Guidance should be provided as to the scope of the deliberations of advisory commissions: whether it is limited to a mere review of the tax adjustment in order to verify the application of Article 4 of the AC, or it encompasses a global review of the case with the aim to remove double taxation.
- It could be recommended to tax administrations that solutions reached in an arbitration procedure should be extended, where appropriate, to related adjustments not covered by the arbitration procedure.
- It should be clarified whether or not the application of the agreements resulting from the arbitration procedure are always subject to the approval of the taxpayers involved in the case.

7. Publicity of opinions of advisory commissions

Suggestion:

Publication of the opinions (excluding confidential or sensitive information) should become the norm, rather than an exception.

ANNEX: Contributions on the 'second phase' of the Arbitration Convention by members of advisory commissions

Respondent 1

Time limits

My main comment on the current procedure is that the time limit envisaged by Article 11 of the Convention (six months from the date on which the matter is referred to the Advisory Commission) is potentially too short. Our panel met on three occasions (in July, October and November 2012). Finding dates that fitted everyone's diary (including those of the Competent Authorities concerned) was difficult. In addition, at the October meeting we invited attendance by the taxpayer and its representatives, which fortunately they could manage. It would not have been easy to schedule another meeting within the six month period guaranteeing attendance by all concerned.

In the event we were able to complete our work and reach a decision within the six month time frame. The issue we had to resolve was not, however, of particular complexity and a transfer pricing issue involving larger volumes of documents and analysis could have been more difficult to accommodate within the time limit.

I appreciate that the aim of the Convention is to achieve a prompt resolution to a dispute that will inevitably have been continuing for some time. I would have thought, however, that an optional extension to one year would offer more flexibility for complex issues. At present the only apparent flexibility is given by paragraph 7.3a of the guidelines, if all relevant documentation is not provided to the panel in advance (see below). This would have allowed me to confirm a later starting date than the first meeting in July 2012, although in fact it was not apparent at that stage that further materials would be produced.

Panel procedure

I encountered no particular procedural problems in chairing the panel. All panel members were helpful, co-operative and approached the arbitration in a positive manner. In between the meetings the panel corresponded by e-mail. The secretarial and administrative assistance provided by one of the Competent Authorities was very efficient. The proceedings were conducted in English and the majority of the documentation was also in English or translations were provided. All meetings were held in the capital city of one of the Member States concerned and there was no difficulty with the administrative arrangements for travel and meetings.

I had anticipated, however, that each Competent Authority ("CA") would have refined its case and obtained all necessary background information and papers before the start of the panel proceedings. This did not prove correct.

The panel members were provided with a pack of papers that gave the basic information and background to the dispute. This included in particular the correspondence from each CA during the MAP setting out its views. Over the course of the panel deliberations, however, further papers were produced and the taxpayer concerned also provided a variety of material for the purposes of its presentation at the panel's October meeting in response to a list of questions devised by the panel.

I would have expected the taxpayer to have provided information and made its case fully to

the CAs concerned before any reference to a panel, so that the taxpayer's information would have been made available at the outset of the procedure.
I assume that the transfer pricing procedures under domestic law (including the powers needed for production of documents and provision of other information by the taxpayer) will differ between Member States. Clearly, however, it would aid the panel in its work (including achieving a decision within the time allowed) if more detailed guidance were given as to the nature of the materials that should be supplied to the panel before it commences its work.

Panel composition

The CAs are necessary participants in the arbitral process, although it is unclear why their representatives are members of the panel. Much of the meeting time was taken up by continuing exchanges of view between the CAs' representatives, as each made its case. As they are members of the panel it can be more difficult for the Chairman to constrain or cut short such exchanges than if the CAs were present as, effectively, advocates for their respective positions.
Inevitably, the CAs representatives in my case voted for their own position, as I had expected.
The main reason for the CAs not to be members of the panel is that their presence may inhibit necessary discussion of the issues among the independent members. In fact, with the CAs' agreement in my case the independent members did meet and communicate separately to discuss their views of the issues. This should happen as a matter of course without either CA feeling that their position is prejudiced by such action. This would be guaranteed if the CAs were not members of the panel.

Panel remuneration

Although the meetings proved decisive in arriving at a decision, a great deal of preparatory work had to be undertaken before the meetings and then afterwards to reflect the discussion at the meetings. Once the panel had concluded I wrote the panel's decision for its final approval. This all took considerable time that is not reflected in paragraph 7.3f of the guidelines. Although the CAs may agree a different basis of remuneration, my impression was that they would have been reluctant to agree anything different. It would seem appropriate to provide some recognition in paragraph 7.3f for time spent in meeting preparation and decision writing.

Respondent 2

1) According to the Convention the Advisory Commission consists of an independent chairman from a third country, one or two independent member from each state and two representatives of each of the competent authorities of the two states involved, The Commission shall adopt its opinion by a simple majority of its members.

2) This means that the representatives of the two competent authorities, that have been unable to come to a common solution, are full members of the commission having voting power. Although it is of great value to have them on the commission in order to give the three independent members full information on all aspects of the case including their own position and the reasons for it, my experience is that it is not very fruitful that they also have the right to vote on the decision. On the contrary this seems to be an obstacle for reaching a unanimous agreement within the commission as they seem to have great difficulties to change their initial positions in the case. However, the independent members of the commissions that I have participated in have seen it as one of our first tasks to find out whether there are any possibilities to get the two parties to compromise in full or in some part. The answers have been a clear no, as in other commissions, whose member I have been talking to.

This means that in practice the decision of the commission is generally taken by the three independent members only, unless they agree to fully support the view of one of the states.

In order to get the disputing parties to agree on a compromise it would probably be easier, if it from the commission's decision cannot be detected whether the competent authorities have agreed to a compromise or not or whether they have abstained from defending their initial position. Under the existing system no member of the few commissions that have been at work, and with whom I have spoken, have seen any sign of a willingness from the states involved to compromise. If it is desirable to give the commission a possibility to get to a decision that both states can agree to, it would be advisable that the representatives of the two states involved should not have any vote and should not have to sign the decision. Finally it is from a point of principles strange and very uncommon in the field of arbitration that the two disputing parties are full members of the arbitration commission.

3) Although in practice it has not been any problem for the three independent members to be allowed to have separate deliberations, which has been necessary in order to discuss and formulate a separate common majority view and the final decision of the commission, as the decisions of the commissions have been decided by these three members only. Therefore this possibility of separate deliberations and the fact that a majority decision within a commission of seven members can be taken of three members only, should expressly be included in the Convention.

4) My and other's experiences are that the independent members, all have shown great integrity and have acted fully neutrally, without being biased in any way in favour of their home state.

5) The Convention does not give a correct picture of how the commissions are working and of the workload of the commission. Most of the work, such as reading all material (the number of pages has been more than 1000 in each case, sometimes in a bad English translation from the original language), discussing difficult questions, drafting the decision, etc. is made outside the official meetings with frequent use of e-mail. Only a minor part of the

work has been done during sessions. That should be reflected in the Convention also with regard to its administrative effects.

6) Based on my experiences from the first commission, the procedure of the second commission was changed in so far as instead of having a full day session plus travels the day before and in the late evening the session day, we had two half day sessions each time we met, beginning the first day at lunch time and ending in the afternoon the second day. That gave us the possibility to fly in the first session day and fly home in the late afternoon the second day. Our common experience was that this procedure was very efficient and also gave room for valuable informal discussions and possibilities to bring forward supplementing information to the second day.

7) Both written information and especially oral hearings with the representatives of the enterprises involved were in both cases very informative and of importance for the final decision, especially if not only tax experts but also representatives from high operational positions , familiar with the business strategy of the company, reasons behind the transfer pricing strategy, international market conditions, etc. looking at things from another angle than taxation.

8) In both cases the states involved have not allowed anything about the commission or its decision to become public. I think that is unfortunate. Information about these decisions and the basis and motives for the decisions could be very valuable both for tax authorities in other states and for other multinational enterprises. It could form the basis for an internationally more homogenous treatment of the problems involved in transfer pricing issues. It is not only questions within the framework of the OECD Transfer Pricing Guidelines that have to be answered. To my experience also more important and general legal issues than could be expected have appeared in these transfer pricing cases. Therefore, publication of the decisions, generalized and in an anonymous form, should be the norm but with a possibility for the commission in certain cases to decide to limit the publication or even exclude publication. With regard to the decisions of the two commissions, that I have participated in, both being extensively and well and clearly motivated, there would have been no problem to publish the main points of the decisions without any risk of exposing the companies involved.

9) That the number of cases brought to arbitration has been very few does in my view not mean that the Arbitration Convention is an inefficient instrument. I believe that the possibility or risk of arbitration in many cases has inspired the competent authorities to really try to get to an agreement by themselves, instead of bringing the case to arbitration of which they would have no control. That is also an important and valuable effect of the Arbitration Convention.

10) There exist other forms of arbitration, such as the so called “base-ball arbitration”, which is applied by the United States and Switzerland in some of their tax treaties. In baseball arbitration the arbitration commission does not make any independent analysis of the issues or should not try to find a correct solution on the dispute . Their only task is to decide which state that has motivated its position on the issues most convincingly. These commissions can of course work faster and may be cheaper, but their decisions cannot be used as guidelines for solving future cases. For these and some other reasons the EU model of arbitration commissions is to be preferred.

Respondent 3

1. Feedback on the administrative aspects of the procedure.

- Good level of cooperation by the competent authorities of the Member States involved during the second phase of the AC.
- It should be also be noted the high level of proactivity and assistance carried out by the secretariat that assisted the chairman throughout the procedure.
- The AC procedures that took place before the second-phase lasted more than expected according to the AC rules.
- Several members of the advisory commission (including the chairman) asked for further documentation as well as for clarifications of the information provided by the Member States before the first meeting of the advisory commission, and such circumstance caused some delays to the effects of point 7.3.(a) of the AC Code of Conduct (2009).
- The advisory commission needed more than 6 months for delivering its opinion due to the complexity of the case and the volume of the documentation that had to be reviewed.
- The taxpayers involved did not asked to present the case before the advisory commission. The members of the advisory commission (except the chairman) did not showed any interest to hear the point of view of the taxpayers, or to carry out any cross-examination of the taxpayers. However, the advisory commission held a hearing and cross-examination with the tax examiner (field auditor) that undertook the tax audit procedures and tax assessment related with the case at hand, which was very helpful to clarify some aspects of the case.
- The competent authorities of the member states involved in the case needed to supplement the solution provided within the second phase of the AC with a mutual agreement establishing a symmetrical assessment (or corresponding adjustment) for the years not covered by the AC procedure. This was very useful, and it that sense it should be noted that such circumstance is very common in the transfer pricing arena inasmuch as most of the related transactions result from long term agreements/contracts that have effects during more than one tax year. In that sense, it could be recommended to the EU Member States that any tax assessment or adjustment carried out by their tax authorities that can be affected by the result of a AC procedure referred to different tax years (but the same case and taxpayers) would be suspended until the duration of the AC procedures, and that the solution achieved through the AC procedures would be extended to such tax adjustments that were suspended.
- The duration of the AC procedures in practice can exceed what it is considered a reasonable time to have justice or get a final court ruling (5-6 years from the notification of the tax assessment), and in that sense the EUTPF should review the AC procedures in order to find ways to shorten the duration of such procedures.

2. Personal opinion on whether or not the AC and its related Code of Conduct provided with sufficient information and guidance for a smooth functioning of the so-called "second phase" of the AC, or whether certain provisions would need to be improved.

In my humble opinion, the Arbitration Convention constitutes a "open legal system" and in that sense there are a several provisions and issues related to its application that are not entirely clear, and that should be clarified to the extent possible:

- The interrelationship between the domestic procedures for the review of the tax assessment/adjustments issued by the tax authorities of the Member States and the AC procedures needs more clear rules and guidance. In particular, the positions of the Member States with regard to article 7.3 of the AC should be established in a more clear way, and analysis of the consequences of such position should be carried out in order to rethink its impact on the smooth working of the AC procedures.
- In my view, it is not entirely clear whether or not the application and the execution of the agreements resulting from of the AC procedures are always subject to the approval of the taxpayers involved in the case (art.7.3 of the AC only requires such approval in specific cases).
- Some measures providing the taxpayers with some mechanisms to enforce the taxpayer´s rights laid down by the AC should be introduced. In particular, some of the more troublesome cases could be those involving the taxpayers right to access to the AC procedures, inasmuch as the competent authorities could easily obstacle such access just invoking that the case it is not suitable for arbitration, or that it is out of its scope of application, etc. Also some kind of last-resort mechanism safeguarding the taxpayer basic rights within the AC procedures should be considered. For instance, an EU AC Steering/Assistance Group (or EU AC Consultation Board) could be an idea to be explored for protecting the taxpayers and for providing informal (public) guidance to the member States tax authorities and the advisory commissions.
- In the same sense, probably some guidance on the cases that could be considered as abusive (i.e. AC shopping cases and artificial schemes), and consequently out of the scope of the application of the AC procedures, would be useful. It should be also considered how the member states have introduced a new generation of antiabuse provisions (for instance, affecting the characterization of the transactions or the fiscal deductibility of financial expenses) that capture intragroup transactions and it is not always clear whether or not the consequences of its application are covered by the AC.
- The competences of the advisory commission for establishing or reaching a solution eliminating the double taxation are not entirely clear (see art.7 of the AC). In my view, the advisory commission is entitled to reach a solution that eliminates the double taxation on the case object of the AC tax procedures, and its competences are not limited to a mere review of the tax adjustment in order to verify whether or not constitutes a right and fair application of the arm´s length principle laid down in article 4 of the AC. In my humble opinion, the advisory commission can carry out a complete review of the facts and circumstances of the case, and provide a new approach on the application of the arm´s length principle when establishing its award and legal opinion for the elimination of the double taxation on the case object of the AC procedures. It can also be posed the issue of the application of the EU Treaty and the ECJ jurisprudence on tax matters during the AC procedures, particularly during the second phase of the AC.
- Considering the centrality of article 4 of the AC and that it has been shaped as an elusive principle, probably more guidance on its meaning and extent is needed.

Respondent 4

My main criticism of the Arbitration Convention is the presence of the tax authorities on the advisory commission. I can understand that when the AC was new this may have been necessary to obtain the agreement of states to it, but it goes against all the principles of arbitration to have interested parties on the advisory commission who do not want to prejudice their jobs by agreeing with the other side's view. More importantly it considerably delays the proceedings while they demonstrate to the others the strength of their views in what is a continuation of a process in which by definition they could not agree. If they had not been there I would expect that the arbitration involving three separate days could have been completed in two. I would have no objection to their being present during discussions (except at the end when the opinion is being discussed) but not as voting members of the commission.

I do not think we had any problems with the Code of Conduct in relation to the smooth functioning of the second phase, but I have the following comment.

Point 7.3. From my experience the Code of Conduct gives a misleading impression of how the commission works. In my case a lot of time was spent outside meetings reading papers, exchanging emails, and agreeing the wording of the opinion. It follows that fixing the remuneration of the independent persons by reference to meeting days seems odd. For example, travel from London to Helsinki takes the best part of a day taking the 2 hour time change into account (for example an 11.20 flight from London arrives at 16.20), and we had three separate meetings (although one was in Stockholm which is closer and has only a one hour time change), plus there was considerable reading time and the time spent agreeing the opinion, none of which was remunerated. While it is possible to agree a different basis of remuneration this requires both states to agree and I suggest that a basis that related to time spent would be fairer. By way of example, I have been involved in chairing an arbitration under a tax treaty and the remuneration was expressed as US $3,000 per day of work (which did not involve any travel as it was done on paper and conference calls).