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EU JOINT TRANSFER PRICING FORUM

REVISED

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

Meeting of 5 November 2013

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Secretariat's Note

The present discussion paper is a working document which aims to facilitate the discussions of the JTPF on the improvement of the functioning of the Arbitration Convention. The structure and content of this document are therefore functional and do not necessarily represent a template for the final outcome of the monitoring of the Arbitration Convention.

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. Initial comments by JTPF members on the improvement of the functioning of the AC and its CoC were collected in 2012. These were 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 were summarized in document JTPF/003/2013/EN. Contributions received from JTPF members informed the preparation of a discussion paper on ways to improve the functioning of the Arbitration Convention (JTPF/002/2013/EN) presented at the JTPF meeting on 14 February 2013. Following the meeting MS were asked to clarify some additional issues listed in document JTPF/002/2013/EN and/or identified during the discussions.
4. In preparation for the June 2013 meeting members of advisory commissions were asked to contribute to the monitoring of the functioning of the AC by sharing their experiences in arbitration panels. Their comments were summarized in document JTPF/010/2013 and were discussed at the meeting in June 2013.
5. The present revised discussion paper builds on the contributions of JTPF members and members of advisory commissions, as well as on the discussion held at the JTPF meeting in June 2013. It contains a work plan (section B) which sets out two categories of issues identified for discussion by the JTPF in line with the proposal made by NGMs and agreed after the meeting in June 2013: issues which should be discussed at the meeting in November 2013 (section C) and issues foreseen to be discussed in 2014/2015 (section D).
6. The approach taken in this discussion paper focusses on addressing the issues by way of amending the CoC. Some issues, for example the implications of the new Article 7 OECD Model Tax Convention ('OECD MTC', see section C item 11) may require thoughts beyond the CoC, i.e. on the AC itself. However, the work of the JTPF with respect to the AC as a multilateral convention between the MS would be limited to a technical discussion.

B. Revised work plan

Overview of items to be addressed in the context of the monitoring of the AC

(numbering as per doc. JTPF/002/2013/EN)

November 2013	2014/2015
1.4 Q2 Flexible interpretation of time limits 1.4 Q1 and 1.9 Denying access to AC 1.8 Implications of MAP result for other years 2.1 Webpage with MS information on MAP 2.3 Cases not 'ripe' for the AC 2.4 MAP request to both CAs 2.8 Independence of CA from audit 2.10 No waiver of rights for audit settlement 3.2 Guidance on position papers 4. Improving the 'second phase' (suggestions by members of advisory commissions) 5. Serious penalties 6. Implication of the new Art. 7 OECD MTC	2.5 Guidance on multilateral MAP (OECD) 2.6 Information submitted in MAP but not in audit 2.11 MS practices on suspension of tax collection 2.13 Informing taxpayer during MAP 3. Information not sufficient for MAP 3.4 Cancelling MAP 7. Change to baseball arbitration 8. AC and arbitration under DTA

C. Issues for discussion at the November 2013 meeting

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

7. 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.

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. 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 making a recommendation in this respect? It could be added after the first paragraph in point 4 of the CoC?

2. Denying access to the AC (items 1.4 Q1 and 1.9, doc JTPF/002/2013/EN)

8. The statistics on pending Mutual Agreement Procedures (MAPs) under the Arbitration Convention at the end of 2012 contain information on the number of requests for MAP rejected by competent authorities and on the reasons for rejection (Table 3 of the statistics). The responses received indicate that in 2012 only very few request were rejected by the reporting CA. Nevertheless it might be useful to consider this issue.

9. Access to the AC (MAP or arbitration) may be denied if:

    a. the request does not appear to be covered by the AC, i.e. is considered as not being an issue in the meaning of Article 4 AC or

    b. one of the enterprises involved is liable for a serious penalty (for the adjustment under review), or

    c. under national law the contracting state involved is not allowed to derogate from judicial decisions and the enterprise involved does not waive domestic judicial review.

10. Article 4 of the AC reflects the formulations in Articles 7 and 9 OECD MTC. The comments received do not indicate that the provision itself is unclear (on the implications of the new Article 7 see section 11 below) and the problems reported do not relate to issues arising from the provisions themselves, but rather to the interaction with other Articles, e.g. Article 5 OECD MTC (see e.g. case study 2 in doc. JTPF/020/REV1/2012/EN). According to this contribution, an issue arising with respect to the attribution of profits would not be referred to the AC as long as it is unclear whether Article 4 (1) or Article 4 (2) of the AC applies. If a Double Taxation Convention (DTC) is available the issue could be referred to the MAP available under the respective DTC, but in case it does not contain an arbitration clause, the taxpayer might find himself in an adverse position compared to the AC.

11. The problem would be avoided in cases where the applicable DTC would contain an arbitration clause, or if general arbitration, including for disputes on the application of Article 5, would be available within the EU[1]. In case a revision of the AC is envisaged, extending its scope to all issues of double taxation would also solve the problem.

12. In the context of the CoC, the issue may be addressed by recommending to the taxpayer to prepare an application for MAP under the DTC for the issues not covered by the AC and in parallel an application for MAP under the AC for the issue covered by Article 4(1) or 4(2) AC to ensure that the deadline under Article 6(1) AC does not expire. The 2-year period of Article 7(1) AC may then have to be extended accordingly.

For discussion:

Do you think that a recommendation to this effect after paragraph 6.1 (b) CoC would be useful?

Proposed text:

If the access to AC or the treatment of cases under the AC directly depends on the result of a MAP under an applicable Double Taxation Convention, it is recommended to file a separate request under the AC to ensure that the deadline under Article 6(1) AC does not expire. In application of Art 7(4) AC, the 2-year period referred to in Article 7(1) AC accordingly should be extended accordingly.

13. In case of denied access to the AC, disputes may arise about whether the denial was justified or not.

For discussion:

Is it possible in your MS for the taxpayer to appeal against denied access to the AC. If so, do you regard this as sufficient?

[1] Further to its Communication on Double Taxation in the Single Market, COM(2011) 712 final, the Commission is currently exploring the possibilities to establish a mechanism to effectively and swiftly resolve disputes in all areas of direct taxation within the EU.

Do you think procedures (e.g. arbitration) can and should be implemented in the CoC for addressing denied access to the AC?

3. Cases not 'ripe' for the AC, disputes likely to arise (item 2.3, doc JTPF/002/2013/EN)

14. Under item 2.3 of doc JTPF/002/2013/EN the issue was raised that the final tax assessment may be deferred by a MS and as a result the case would not be submitted to MAP.

15. The AC foresees that for cases where double taxation is likely to arise, MAP requests under the AC may already be submitted in advance. This possibility may, however, be evaluated from two angles. On the one hand it may be regarded as providing the advantage to address disputes at an early point in time; on the other hand an early submission to MAP may be regarded as impeding efforts to solve the issue before MAP. As a further point it should be taken into account that the burden for CAs in dealing with cases where double taxation did actually arise is already quite high.

For discussion:

In light of the considerations described above, is it desirable to make a recommendation for an early submission?

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

16. The following questions were raised and the JTPF considered 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?

17. 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.

18. 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:

It is recommended that CAs apply a simplified procedure for MAP requests linked to issues which are already covered by an ongoing MAP. This simplified approach might consist of treating 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?

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

19. At its meeting in February 2013 the JTPF saw a benefit in publishing on the Commission website the country specific information available on the OECD website for all EU MS, including those which are not members of the OECD[2]. A compilation of the respective MS TP legislation on the JTPF website would especially be useful as some JTPF reports refer to domestic legislation and practices and provide guidance on how to deal with these differences in practice (see e.g. secondary adjustments). The Secretariat has clarified the technical aspects of the publication on the JTPF website. It is possible to create a section "MS TP country profile" (*final title still to be decided)* where for each MS a pdf document containing specific transfer pricing information would be published. The Secretariat has prepared a template and has compiled available information per MS drawing on public sources such as the OECD website and earlier responses to JTPF questionnaires (see ANNEX 1). MS will be asked to review and, if necessary, update and complete this information before its publication. Additional elements may be added to "MS TP country profile" as for example the information suggested by Italy under item 6 below.

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

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

For discussion:

[2] See section 6 (2.1) Summary record February 2013, doc JTPF/005/2013/EN

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) CoC?

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

21. It was suggested to ensure that CAs can decide independently from field auditors. The JTPF agreed that the item should be addressed in line with the MEMAP recommendation, but adapted to the specific structure of some MS.

22. 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 Nº23: 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?

Italy:

After the meeting in June 2013 **Italy** indicated that before deciding about this suggestion it would welcome a prior survey among all MS aimed at clarifying some Competent Authorities issues which may arise at organizational and legal level.

A brief questionnaire should be prepared to gather the relevant information from all MS with respect to their institutional structure, legal framework and policy issues, as well as the relationship between competent authorities, central tax administrations and field tax offices performing audit functions. Experience has shown there might be cases where the decision of a CA is subject to approval or concurrence of others, either formally or informally and there may also be practical restrictions on CA's decision-making ability.

There may be also an issue of inadequate resources especially in staffing (e.g., growth in examination resources without increase of CA personnel).

Moreover, the lack of provisions in domestic statutory law or administrative guidance as well as the possible deference to control of accounting and administrative bodies, are likely to be a limitation of the good functioning of the AC.

The main areas to be covered in the questionnaire could be:

<u>*Organization*</u>

- Which is the structure of the fiscal administration (Ministry of Finance, or Ministry and Revenue Agency) in charge of the relationship with the taxpayer?

- Which organization (Ministry or Revenue Agency) do field offices with audit functions belong to?

- In case the review of an audit is allowed by internal law, which structure (Ministry or Agency) performs the review?

<u>*Personnel*</u>:

- in case the review of an audit is allowed by internal law, do central structures (either Ministry or Revenue Agency) have a proper and adequate number of auditors to review the audits performed by field offices (how many)? Are they second-level auditors?

- In case of a not sufficient number of auditors at central level, do central structures (Ministry or Agency) have the possibility to increase such number by way of new employment or public competition?

- Which structure (Ministry or Agency) has the role of Competent Authority for MAPs involving single taxpayers?

<u>*Legal framework*</u>

- In the assumption that the AC is the legal basis for a review or modification of an assessment made by a field office, does domestic law provide a further level of regulations aimed at disregarding the result of the audit and review a MAP case?

- Are there ad hoc budget allocations to finance the reduction of assessed taxes?

Responsibilities and accountability

If a MAP case is solved through an agreement resulting in a decrease of the taxpayer's tax burden, compared to the tax burden under the final assessment made by the field office performing audit functions, is there any procedure to be followed under internal law to justify the difference between income assessed vs. income resulting from MAPs?

Are the negative financial effects resulting from the conclusion of MAPs subject to the control of accounting and administrative bodies and courts?

Do you agree with launching such a questionnaire? Do you agree with its suggested content?

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

23. 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'* .

24. 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 Nº19: 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 be added after paragraph 6.1 (a) of the CoC?

9. Guidance on position papers *(item 3.2, doc JTPF/002/2013/EN)*

25. At the meeting in February 2013 the JTPF agreed that further guidance on position papers may be useful and the guidance given in the OECD MEMAP was considered as being a useful staring point. Annex 2 to this document contains the current guidance on position papers in section 6.4 CoC, supplemented with additional items taken from the OECD MEMAP.

For discussion:

Do you agree with supplementing the current guidance on position papers in section 6.4 CoC with additional items from the OECD MEMAP?

Do you have further suggestions?

10. Improving the 'second phase' based on suggestions by members of advisory commissions *(item 4, doc JTPF/002/2013/EN)*

26. The comments received from three chairpersons and one member of advisory commissions were included in document JTPF/010/2013/EN and discussed at the JTPF meeting on 6 June 2013. The JTPF agreed that the following items would need further consideration;

- *Composition and functioning of advisory commissions*

27. The composition of an advisory commission is governed by the AC. One suggestion discussed at the last meeting was to consider a recommendation to appoint no more than 1 member per tax administration to the advisory commission as this would ensure that the independent persons of standing and the Chair could decide independently from MS. The possibility to appoint only one representative is already foreseen in Article 9(1) AC.

For discussion:

A recommendation to appoint only one representative from the respective competent authority may be added to paragraph 7.2 (c) CoC after the first sentence.

Proposed text:

For reasons of simplification, it is recommended that competent authorities appoint only one representative for their competent authorities.

Do you agree with this recommendation?

- *Opening statement by the taxpayer and auditor(s)*

28. Although the option to invite a taxpayer to present its case before the advisory commission already exists, the Forum agreed at the June meeting to discuss a recommendation on hearing the taxpayer and the auditor at the outset of the procedure ('opening statements'). Regarding the suggestion for guidance on the

content and the format of the information to be provided to the advisory commission, the Forum considered that - given the fact-specific nature of each case in transfer pricing - it may be difficult to provide detailed guidance.

For discussion:

A recommendation that the advisory commission may in appropriate cases consider to hear the views of the taxpayer and the auditor (s) may be added at the end of paragraph 7.3 (d) CoC.

Proposed text:

The advisory commission may request the taxpayer and/ or representatives of the Member States who were in charge of the adjustment (e.g. the auditors) to state at the outset of the procedure their opinion and to appear before the advisory commission (opening statement).

Do you agree with this recommendation?

- *Timing of the arbitration procedure*

29. At the meeting in June, the Forum regarded the 6-month period envisaged under the AC for an advisory commission to deliver an opinion as generally appropriate. It should, however, be ensured that at the beginning of this time period sufficient information is already available to the advisory commission. Although this is in principle already foreseen in paragraphs 7.2 (f) and 7.3 (a) CoC, a statement may be added that the time until the advisory commission is established may be used by the competent authorities to collect and prepare this information.

For discussion:

The following sentence may be added to paragraph 7.2 (f);

"To ensure that the advisory commission can start its work in a timely manner, the time period needed to establish the advisory commission may already be used by the competent authorities to collect and prepare this information."

Do you agree with this recommendation?

- *Remuneration of chairmen and independent members of advisory commissions*

30. At the June meeting the Forum agreed that it is worth discussing how to appropriately adjust the remuneration of the members of advisory commissions. Members were invited to send their ideas and suggestions. The comments received are included in ANNEX 3. One suggestion is for a minimal increase of the remuneration to account for the inflation rate in the Eurozone. Assuming that the amount of 1000 EUR foreseen in paragraph 7.3 (f) (ii) CoC was agreed in 2003 (first published in 2004[3]), the amount adjusted in relation to the inflation rate in the Eurozone would result in 1.177,57 EUR in 2013. Further some comments indicate reluctance to put further work in defining a "meeting day".

[3] 23.04.2004 COM(2004) 297 final

For discussion:

Trying to capture also future inflation may result in an increase of the remuneration to 1.250,00 Euro.

Do you agree with this proposal or would you prefer a higher/lower amount?

Do you think the term "meeting day" as used in the CoC needs to be more clearly defined?

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

31. On the question, whether or not agreements resulting from the arbitration procedure are/should be always subject to the approval of the taxpayer, Members were invited to send their views.

32. The responses received (ANNEX 4) indicate that there should generally not be a difference between situations where the agreement was reached in the first or in the second phase of the AC. In principle, acceptance by the taxpayer is not formally required under the AC and the agreement reached may therefore be implemented without the taxpayer's agreement. However, the relation between the AC and domestic remedies needs to be considered. Article 7(1) AC blocks the expiration of the 2-year period when domestic remedies have been initiated by the taxpayer, Article 7 (2) allows the Contracting State to initiate or continue judicial proceedings and Article 7 (3) AC provides for cases where the domestic law does not allow the competent authority to derogate from the decision of their juridical bodies that an advisory commission shall not be set up before the time provided for appeal did expire or the right for an appeal was withdrawn. A problematic situation may therefore arise in cases where the taxpayer initiates a domestic remedy against the tax assessment which implements an agreement reached under the AC

33. As already stated in paragraph 45 of the Commentary on Article 25 of the OECD MTC and paragraph 38 of the MEMAP, the concern of a particular competent authority to avoid any divergence or contradictions between the decision of the court and the MAP and the risks of abuse that these could entail should be taken into account. As a result the OECD recommends that the implementation of an agreement should be made subject to

    - the acceptance of the agreement by the taxpayer and
    - the taxpayer's withdrawal of domestic remedies and court proceedings concerning those points settled in MAP under the AC.

For discussion:

A new section 8 may be added after section 7 of the CoC which could be drafted along the lines of the OECD. The numbering of the following sections would change accordingly:

8. Implementation of the agreement:

If the terms and conditions of an agreement reached in the first phase of the AC are not satisfactory to the taxpayer, the taxpayer may withdraw from the MAP process under the AC and pursue to those remedies which are still available under the domestic law.

It is recommended to make the implementation of an agreement reached in the first or second phase of the AC subject to the acceptance of the agreement by the taxpayer and the taxpayer's withdrawal from domestic remedies and appeals concerning those points settled in MAP under the AC.

Do you agree to this recommendation?

In case the taxpayer does not give the agreement in the aforementioned manner, do you think MS have the possibility not to implement the agreement? If so, would the taxpayer have the possibility to appeal against the non-implementation?

For further information, MS responses to the 2009 Questionnaire on the interaction between judicial appeals and the AC[4] may be added to MSs' TP profile on the JTPF website.

11. Serious penalties *(item 5, doc JTPF/002/2013/EN)*

34. MS have made unilateral declarations to the AC on what they consider a serious penalty in the meaning of Article 8 (1) AC. In its summary report on penalties[5] the JTPF concluded that the current situation under the AC, where 27 different definitions of a serious penalty exist does not sit easily with the idea of a single market. Therefore it was agreed that the JTPF will in the future look at what precisely a serious penalty should be for the purposes of the AC. The idea behind this work would be to clarify what a serious penalty is in terms of transfer pricing, so that taxpayers would not be disadvantaged by the existence of different definitions within the EU. However, as the AC is a multilateral convention between MS a common definition could only be recommended to MS for adoption in their unilateral declaration.

35. In the context of revising the CoC in 2009, MS were invited to inform the JTPF on the number of cases where access to the AC was denied because a serious penalty had been applied. At that time only two MS had denied access to the AC. The 2012 statistics on pending MAP cases under the AC also revealed that access to the AC due to serious penalties was denied only in one case. However the NGMs in 2009 expressed their concerns that the outcome did not reflect the pressure that this provision of the AC can put on taxpayers to agree with a non-arm's length adjustment.

36. In 2009, the JTPF recognised that several MS having reflected on their individual declarations had in fact described penalties that should probably not be considered as "serious" within the context of Article 8. Therefore MS were recommended in Section 3 of the CoC to clarify or revise their unilateral declarations in the Annex to the AC in order to better reflect that a serious penalty should only be applied in exceptional cases like fraud.

37. Annex 5 of this document contains a list of these unilateral declarations as they stand now. The existing unilateral declarations are included the MS country profiles intended to be published on the JTPF website.

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[4] See Annex VII of document SEC(2009)1169 final

[5] Document JTPF/002/2007/EN

For discussion:

Would it be desirable to establish a common definition, common criteria or a minimum standard on what constitutes a serious penalty in the meaning of Article 8 (1)?

If so, what should be the key aspects for considering a penalty as serious?

12. Implications of the new Article 7 (item 6, doc JTPF/002/2013/EN)

38. In 2008 the OECD concluded its work on the attribution of profits to permanent establishments with publishing the report "Attribution of Profits to Permanent Establishments", approved by the OECD Committee on Fiscal Affairs in 2008. The report represents the outcome of the work on how the "separate arm's length enterprise" provision of Article 7 should be applied. The conclusions of the Report were implemented in the OECD Model Tax Convention in two stages.

39. The first stage was the revision of the Commentary on Article 7 as Article 7 read before 22 July 2010. This stage was completed in the 2008 update of the OECD MTC. It was aimed at implementing the conclusions of the report that do not conflict with the interpretation previously provided in the Commentary on Article 7. The second stage was the finalization of a completely new article 7 with related Commentary changes in the 2010 update of the OECD MTC.

40. The issue arising from this is whether and if so what implications these developments have on the interpretation of Article 4 (2) of the AC which mirrors the language of Article 7 before 22 July 2010.

41. At the meeting in February 2013 the JTPF concluded that this item should be explored further. It is suggested that this work would start with a discussion of document JTPF/006/BACK/2011/EN – Belgian contribution on interaction between Art 7 and AC (ANNEX 6).

For discussion:

Do you agree with the analysis provided in document JTPF/006/BACK/2011/EN?

If so, which of the options listed do you prefer?

D. Issues foreseen for 2014/2015

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

42. 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 by the JTPF 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.

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

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

43. MS were invited to comment on their practices. MS which have not yet responded are kindly invited to do so asap.

44. 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

45. 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.

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

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

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

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

8. AC and Arbitration under Double Taxation Agreements ***(item 8, doc JTPF/002/2013/EN)***

ANNEXES:

ANNEX 1: Template: MS Transfer Pricing Profile

ANNEX 2: Draft guidance on position papers

ANNEX 3: Compilation of comments received on the remuneration of independent persons of standing and the Chair of an arbitration commission

ANNEX 4: Compilation of comments received on taxpayer's approval to an agreement reached under the AC

ANNEX 5: List of unilateral declarations on serious penalties (Article 8)

ANNEX 6: Belgian contribution on the implications of the new Article 7

ANNEX 1

Template: MS Transfer Pricing Profile

The information on items 1 – 6 and 8 – 10 is taken from
http://www.oecd.org/ctp/transfer-pricing/..........pdf

1. Reference to the Arm's Length Principle

[...]

2. Reference to the OECD Transfer Pricing Guidelines

[...]

3. Definition of related parties

[...]

4. Transfer pricing methods

[...]

5. Transfer pricing documentation requirements

[...]

Implementation of the Code of Conduct on Transfer Pricing documentation:

Administrative or legal action taken to implement the EU TPD Code of Conduct:

Link to a future summary of responses [...]

Specific national transfer pricing documentation rules/guidance and national practice compared to the EU TPD?

Link to a future summary of responses [...]

6. Specific transfer pricing audit procedures and / or specific transfer pricing penalties

[...]

Link to a future summary of responses [...]

7. Information for Small and Medium Enterprises on TP

Link to future section on JTPF website […]

8. Information on dispute resolution under the Arbitration Convention

Information to be added from: http://www.oecd.org/ctp/dispute/…. .htm

[…]

Dispute resolution under the Arbitration Convention does not need to be initiated and may be suspended if one of the enterprises involved is subject to a 'serious penalty' for the transactions giving rise to the profit adjustment (Article 8).

Definition to be added from EurLex

9. Relevant regulations on Advance Pricing Arrangements

[…]

10. Links to relevant government websites

[…]

11. Other relevant information

Secondary and compensating year-end adjustments may result in double taxation. Two questionnaires launched by the EU Joint Transfer Pricing Forum (JTPF) in 2011 took stock of the situation prevailing in each EU Member State with respect to secondary and compensating year-end adjustments as on 1 July 2011. and served to prepare an

11.1 Secondary Adjustments - overview on the legal and administrative/practical aspects in the different Member States (*hyperlink* - *http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/transfer_pricing/forum/jtpf/2012/jtpf_018_rev1_2011_en.pdf*).

11.2 Compensating/year-end Adjustments - overview on the legal and administrative/practical aspects in the different Member States (*hyperlink* -

http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/transfer_pricing/forum/jtpf/2012/jtpf_019_rev1_2011_en.pdf).

11.3 Others

[…]

ANNEX 2

Guidance on position papers

6.4. Exchange of position papers

(a) Member States undertake that when a mutual agreement procedure has been initiated, the competent authority of the country in which a tax assessment, i.e. a final decision of the tax administration on the income, or equivalent has been made, or is intended to be made, which contains an adjustment that results, or is likely to result, in double taxation within the meaning of Article 1 of the Arbitration Convention, will send a position paper to the competent authority(ies) of the other Member State(s) involved in the case setting out:

(i) Basic information:

- Legal name and address and taxpayer identification number of the person requesting assistance, its related persons in the other country, if applicable, and the basis for determining the association;
- The contact details of the competent authority official in charge of the case
- Broad overview of the issue, transactions, business, and basis for adjustment
- Applicable taxation years
- Amount of income and tax adjusted for each taxable year, if applicable
- Summary of relevant information from the original tax return

(ii) the case made by the person making the request;

- description of the exact nature of the issue or adjustment
- if relevant, calculation with supporting data (may include financial and economic data and reports relied upon and explanatory narratives as well as taxpayer documents and records where relevant and appropriate

(iii) its view of the merits of the case, e.g. why it believes that double taxation has occurred or is likely to occur;

(iv) how the case might be resolved with a view to the elimination of double taxation together with a full explanation of the proposal.

(b) The position paper will contain a full justification of the assessment or adjustment and will be accompanied by basic documentation supporting the competent authority's position and a list of all other documents used for the adjustment, e.g.

- Outline of comparable transactions and methods for adjusting differences;

- Description of the methodology employed for the adjustment; and
- An explanation of the appropriateness of the transfer pricing methodology employed for the adjustment (i.e. an explanation why it believes the adjustment achieves an arm's length outcome; identification of tested party, if applicable; industry and functional analysis, if a relevant study is not already included elsewhere in the taxpayer’s submission).

(c) The position paper will be sent to the competent authority(ies) of the other Member State(s) involved in the case as quickly as possible taking account of the complexity of the particular case and no later than four months from the latest of the following dates: (i) the date of the tax assessment notice, i.e. final decision of the tax administration on the additional income, or equivalent; (ii) the date on which the competent authority receives the request and the minimum information as stated under point 5(a). EN C 322/6 Official Journal of the European Union

(d) Member States undertake that, where a competent authority of a country in which no tax assessment or equivalent has been made, or is not intended to be made, which results, or is likely to result, in double taxation within the meaning of Article 1 of the Arbitration Convention, e.g. due to a transfer pricing adjustment, receives a position paper from another competent authority, it will respond as quickly as possible taking account of the complexity of the particular case and no later than six months after receipt of the position paper

(e) The response should take one of the following two forms:

(i) if the competent authority believes that double taxation has occurred, or is likely to occur, and agrees with the remedy proposed in the position paper, it will inform the other competent authority(ies) accordingly and make such adjustments or allow such relief as quickly as possible;

(ii) if the competent authority does not believe that double taxation has occurred, or is likely to occur, or does not agree with the remedy proposed in the position paper, it will send a responding position paper to the other competent authority(ies) setting out its reasons and proposing an indicative time scale for dealing with the case taking into account its complexity. To enable the competent authorities to identify the areas of disagreement and to understand the position of the responding competent authority, a rebuttal or response paper could include the following:

- Indication of the areas or issues where the competent authorities are in agreement or disagreement;
- Requests for additional information and explanations necessary to clarify particular issues;
- Presentation of other or additional information considered pertinent to the case, but not raised in the initial position paper; and

- Submission of proposals or views to resolve the issue

The proposal will include, whenever appropriate, a date for a face-to-face meeting, which should take place no later than 18 months from the latest of the following dates:

(aa) the date of the tax assessment notice, i.e. final decision of the tax administration on the additional income, or equivalent;

(bb) the date on which the competent authority receives the request and the minimum information as stated under point 5(a).

(f) Member States will further undertake any appropriate steps to speed up all procedures wherever possible. In this respect, Member States should envisage to organise regularly, and at least once a year, face-to-face-meetings between their competent authorities to discuss pending mutual agreement procedures (provided that the number of cases justifies such regular meetings).

ANNEX 3

Compilation of comments received on the remuneration for the independent persons and the Chair of an arbitration commission

Bulgaria

Bulgaria has no any experience with arbitration procedures so the compensation for the members of the advisory commissions has not been an issue yet. One solution could be to agree on a time-based remuneration where each member of a commission could keep time-sheets or similar records providing information on the time spent on a specific case.

Cyprus

As regards remuneration of members of Advisory Commission I fully agree with suggestion made by President for every one day meeting there is one day preparation

Denmark

Ideas on how to adapt the remuneration for members of advisory commissions:

At the meeting it was concluded that it was not the right time for an adjustment exceeding the general raise in prices. A possible solution could be to adjust the prices according to for eg. the Euro Area Inflation Rate.

Germany

The summary of suggestions made by former members of advisory commissions (DOC JTPF/010/2013/EN of May 2013) features, among other suggestions, the suggestion that work outside official meetings (such as reading material, exchanging emails etc.) should be recognized and that remuneration should be fixed by reference to actual time spent on the case and not on the basis of meeting days.

Germany does not support that suggestion.

The current Revised Code of Conduct (as the original Code of Conduct) suggests 1000 EUR per independent person per meeting day (1100 EUR for the chairperson). According to the summary records of those years, this recommendation was developed in 2002 and 2003 after intense discussions (see, in particular, the summary record of the September 2003 JTPF meeting). It is noteworthy that the original proposal (in a working paper of November 2002, DOC JTPF/007/2002/REV1/EN) was a fee of EUR 1000 per person “per full day spent on the case” (with a limit of a total amount of “EUR 100000 per opinion”), and the current wording “per meeting day” was developed later. Unfortunately, the 2002 and 2003 documents do not clearly show the reasons for changing “per full day spent on the case” to “per meeting day”. It has to be stressed, however, that it was always clear that the arbitrators would have to spend more days on a case than just the meeting days. However, arguments against a rule that takes into account the actual time spent on the case are fairly obvious: (a) It seems difficult to keep track of the actual time spent on a case; (b) the remuneration, to be paid by the tax administrations involved, can easily reach very high total amounts if 1000 EUR per actual day

spent on the case is used; and (c) taking into account the actual time spent would almost necessarily lead to different remunerations for each member of the advisory commission because the individual time spent on a case will be different.

The lump sum of 1000 EUR per meeting day as agreed in 2003 was never meant to be an incentive for potential members of an advisory commission of standing to make it economically attractive to serve as an independent person of standing in an advisory commission. Rather, it seems that serving as a member of an advisory commission was always understood as an honorary appointment, comparable to serving in a jury in a regular court procedure.

The fee was not calculated on the basis of a fee that the independent person of standing could have earned otherwise spending the same time in the regular work, e.g. as a lawyer in private practice. A different understanding would probably necessitate a totally different approach to establishing the list of potential independent persons and to selecting them for actual advisory commissions. If the idea was to compensate independent persons at their “market prices”, e.g. attorney fees, procurement law with all its complexities including mandatory invitations for tenders etc. might apply. Germany does not support such an approach.

The German experience with establishing advisory commissions suggests that persons of standing continue to be interested in being on the list and in serving in actual advisory commissions. Thus, there does not seem to be an actual need to make service as independent person financially more attractive.

In summary, Germany suggests leaving the Code of Conduct’s provision on the remuneration of independent members of the advisory commission unchanged

United Kingdom

We agree, in principle, the German proposal to uplift the amount of remuneration by inflation is reasonable. Beyond this we believe there is no need to change the basis for remuneration and that this issue doesn't merit further discussion at this time.

ANNEX 4

Compilation of comments on taxpayer's approval to agreements under the AC

Bulgaria

The arbitration agreements are only presented to the taxpayers involved by the competent authority. According to our law and administrative practice their approval is not needed. The taxpayers involved have other instruments to contest the result of the agreement, i.e. appeals before courts.

Cyprus

As regards last point we have no practice on the matter. We have the confidentiality of taxpayer in the case of a decision of an administrative authority. Court Cases are published. An advisory commission is not an administrative authority. Therefore approval of taxpayer not required and I do not think that it should be required. Taxpayer should know that his case will be published. Therefore with a decision of the Minister of Finance decisions of arbitration commission are published.

Denmark

Views and country practices/legal frameworks on the issue of whether or not agreements resulting from the arbitration procedure are always subject to the approval of the taxpayer:

In Denmark the taxpayer will always be asked to accept the result of a mutual agreement procedure (either after an Article 25-procedure in the OECD Model Tax Convention or after a procedure according to the Arbitration Convention). If the result is not accepted the double taxation is upheld.

Denmark has not had any experience with results from arbitration panels.

In point 45 of the Commentary on Article 25 of the Model Tax Convention it is stated that an acceptance by the taxpayer is normally required, see also point 3.8 of the MEMAP.

Germany

Views and country practices/legal frameworks on the issue of whether or not agreements resulting from arbitration are always subject to the approval of the taxpayer

Germany issued administrative principles in a Federal Ministry of Finance Circular of 13 July 2006 on the application of the Arbitration Convention (available in German and in an unofficial English translation) athttp://www.bzst.de/DE/Steuern_International/Verstaendigungsverfahren/Merkblaetter/BMF_Schreiben_2006_07_13.html

http://www.bzst.de/EN/Steuern_International/Verstaendigungsverfahren/BMF_Schreiben_2006_07_13.html?nn=26140.

Point 13.6.4 of that Circular provides that, with respect to the implementation of CA decisions that implement opinions of advisory commissions, the same rules apply as for the implementation of ordinary mutual agreements. For ordinary mutual agreements, point 4.2 of the circular provides that they will only be implemented if (1) the applicant agrees with the implementation, (2) pending appeals on the issue are withdrawn, and (3) following the tax assessment notice implementing the mutual agreement, the applicant waives any appeal against such tax assessment, provided that the results of the mutual agreement are correctly implemented. In other words, Germany implements decisions following arbitration opinions only subject to the taxpayer's approval.

Concerning the theoretical foundation for requiring the taxpayer's approval, the following arguments can be put forward:

The Arbitration Convention itself is silent on whether implementation of a mutual agreement (be it before or after arbitration) requires the taxpayer's approval.

This is slightly different with respect to Article 25 of the OECD Model Tax Convention (MTC). While Article 25 itself is silent on the necessity of approval for an ordinary mutual agreement between CAs, paragraph 5 of Article 25 on arbitration explicitly provides for implementation of a mutual agreement that implements an arbitration decision only if all persons directly affected by the case accept the mutual agreement. However, even in the absence of an explicit approval rule for ordinary mutual agreements (i.e. agreements without arbitration), the OECD Commentary suggests that normally, implementation of a mutual agreement should be made subject to the acceptance of such mutual agreement by the taxpayer (see paragraphs 45, 76 and 82 of the OECD Commentary on Article 25 of the OECD MTC).

The same reasons as set forth in the OECD Commentary should apply under the EU Arbitration Convention (AC).

In particular, it is worth noting that there may still be pending domestic appeals even if an advisory opinion under the Arbitration Convention has already been rendered. One may argue that the 2-year period of Article 7(1) of the AC (at the end of which arbitration becomes mandatory) does not start in case of pending domestic court procedures, as provided in the second subparagraph of Article 7(1) ("where the case has so been submitted to a court or tribunal, the term of two years … shall be computed from the date on which the judgment of the final court of appeal was given"). However, that sub-paragraph only talks about cases submitted to courts or tribunals. In Germany, it is generally understood that this provision does not cover cases in pending administrative appeals (which may later become court cases). In other words, there can be pending administrative appeals cases, and still the 2-year period may start and eventually end, with the consequence of AC arbitration, while the domestic appeal is still pending.

United Kingdom

There is no requirement in the UK to get the taxpayer's approval to the outcome of the arbitration panel’s deliberations, unless the taxpayer has suspended its domestic appeal. If it has done so, paragraph 22 of HMRC’s Statement of Practice 1/11 offers the taxpayer the possibility to reject the MAP agreement and pursue the domestic remedies that had been suspended. That paragraph would also apply if the MAP resolution were to be reached by the arbitration panel, rather than by the competent authorities of the member states.

ANNEX 5

Unilateral Declarations on Article 8 of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises

Declaration by Austria (*Official Journal C 026, 31/01/1996 P. 0001 – 0033)*

An infringement punishable by a 'serious penalty' is constituted by any intentional or negligent evasion of tax or duty that is penalized under the law on tax offences.

Declaration by Belgium (*Official Journal L 225, 20/08/1990 P. 0010 – 0024)*

The term 'serious penalty' means a criminal or administrative penalty in cases:
- either of a common law offence committed with the aim of tax evasion,
- or infringements of the provisions of the Code of income tax or of decisions taken in implementation thereof, committed with fraudulent intention or with the intention of causing injury.

Declaration by Bulgaria (*Official Journal L 174, 03/07/2008 P. 0001 – 0005)*

The term 'serious penalties' means penalties of every kind, imposed for actions constituting administrative or tax infringements, including infringements of procedural law concerning tax assessment and tax collection, as well as for crimes against the tax system. 'Serious penalties' imposed on the enterprise are also deemed to exist when penalties are imposed for offences committed against the tax system on an individual from that enterprise whose actions have influenced the amount of tax liabilities of the enterprise or the collection therewith.

Declaration by Cyprus (*Official Journal C 160, 30/06/2005 P. 0011 – 0022)*

The term 'serious penalty' includes penalties for:
(a) fraudulently or willfully making or submitting a false statement, return, document or declaration in respect of income or claims to any allowances or deductions;
(b) fraudulently or willfully submitting false accounts;
(c) refusing, failing or neglecting to submit a tax return;
(d) refusing, failing or neglecting to keep proper records or to make documents and records available for inspection;
(e) aiding, assisting, counseling, inciting or inducing a person to make, deliver or furnish any return, statement, claim, accounts or document, or to keep or prepare any accounts or documents, which is or are materially false.
The legislative provisions governing the abovementioned penalties are included in the Assessment and Collection of Taxes Laws.

Declaration by the Czech Republic (*Official Journal C 160, 30/06/2005 P. 0011 – 0022)*

An infringement of the tax laws punishable by 'serious penalty' is constituted by any infringement of the tax laws penalised by detention, criminal or administrative fines. For these purposes, by 'infringement of the tax law' is meant:
(a) failing to pay the charged taxes, social insurance taxes, health insurance taxes and fees paid for state policy of employment;
(b) tax or similar payment evasion;
(c) failing in fulfilling notification duty

Declaration by Denmark (*Official Journal L 225, 20/08/1990 P. 0010 – 0024)*

The concept of 'serious penalty' means a penalty for the intentional infringement of provisions of the Criminal Law or of special legislation in cases which cannot be regulated by administrative means. Cases of infringement of provisions of tax law may, as a general rule, be regulated by administrative means where it is considered that the infringement will not entail a punishment greater than a fine.

Declaration by Estonia (*Official Journal C 160, 30/06/2005 P. 0011 – 0022)*

The term 'serious penalty' will be interpreted as signifying criminal penalties for tax fraud pursuant to Estonian domestic law (Penal Code).

Declaration by Finland (*Official Journal C 026, 31/01/1996 P. 0001 - 0033)*

The term 'serious penalties' includes criminal sanctions and such administrative sanctions which are imposed in respect of the breach of tax laws.

Declaration by France (*Official Journal L 225, 20/08/1990 P. 0010 – 0024)*

The term 'serious penalties' includes criminal penalties and tax penalties such as penalties for failure to make a tax return after receiving a summons, for lack of good faith, for fraudulent practices, for opposition to tax inspection, for secret payments or distribution, or for abuse of rights.

Declaration by Germany (*Official Journal L 225, 20/08/1990 P. 0010 – 0024)*

An infringement of the tax laws punishable by a 'serious penalty' is constituted by any infringement of the tax laws penalized by detention, criminal or administrative fines.

Declaration by Greece (*Official Journal C 160, 30/06/2005 P. 0011 – 0022)*

The term 'serious penalties' includes administrative penalties for serious tax infringements, as well as criminal penalties for offences committed with respect to the tax laws in accordance with the relevant provisions of the Code of Books and Records, of the Income Tax Code, as well as all specific provisions which define the administrative and criminal penalties in tax law.

Declaration by Hungary (*Official Journal C 160, 30/06/2005 P. 0011 – 0022)*

The term ‘serious penalty’ means criminal penalties established in relation to criminal tax offences, or tax penalties in relation to tax defaults in excess of HUF 50 million.

Declaration by Ireland (*Official Journal L 225, 20/08/1990 P. 0010 – 0024)*

‘Serious penalties’ shall include penalties for:
(a) failing to make a return;
(b) fraudulently or negligently making an incorrect return;
(c) failing to keep proper records;
(d) failing to make documents and records available for inspection;
(e) obstructing persons exercising statutory powers;
(f) failing to notify chargeability to tax;
(g) making a false statement to obtain an allowance.

The legislative provisions governing these offences, as at 3 July 1990, are as follows:
- Part XXXV of the Income Tax Act, 1967,
- Section 6 of the Finance Act, 1968,
- Part XIV of the Corporation Tax Act, 1976,
- Section 94 of the Finance Act, 1983.

Any subsequent provisions replacing, amending or updating the penalty code would also be comprehended.

Declaration by Italy (*Official Journal L 225, 20/08/1990 P. 0010 – 0024)*

The term ‘serious penalties’ means penalties laid down for illicit acts, within the meaning of the domestic law, constituting a tax offence.

Declaration by Latvia (*Official Journal C 160, 30/06/2005 P. 0011 – 0022)*

The term ‘serious penalties’ means administrative penalties for serious tax infringements, as well as criminal penalties.

Declaration by Lithuania (*Official Journal C 160, 30/06/2005 P. 0011 – 0022)*

The term ‘serious penalties’ includes criminal penalties and administrative penalties such as penalties for lack of good faith and for opposition to tax inspection.

Declaration by Luxembourg (*Official Journal L 225, 20/08/1990 P. 0010 – 0024)*

Luxembourg considers to be a ‘serious penalty’ what the other Contracting State considers to be so for the purposes of Article 8.

Declaration by Malta (*Official Journal C 160, 30/06/2005 P. 0011 – 0022)*

The term ‘serious penalty’ means a penalty, whether administrative or criminal, imposed on a person who willfully with intent to evade tax or to assist any other person to evade tax:

(a) omits from a return or any other document or statement made, prepared or submitted for the purposes of or under the Income Tax Acts, any income which should be included therein;
or
(b) makes any false statement or entry in any return or other document or statement prepared or submitted for the purposes of or under the Income Tax Acts;
or
(c) gives any false answer, whether verbally or in writing, to any question or request for information asked or made in accordance with the provisions of the Income Tax Acts;
or
(d) prepares or maintains or authorises the preparation or maintenance of any false books of account or other records or falsifies or authorises the falsification of any books of account or records;
or
(e) makes use of any fraud, art or contrivance whatever or authorises the use of any such fraud, art or contrivance.

Declaration by the Netherlands (*Official Journal C 160, 30/06/2005 P. 0011 – 0022)*

The term 'a serious penalty' means a penalty imposed by a court due to intentionally committing an offence as listed in Article 68(2), or Article 69(1) or (2), of the General Tax Act.

Declaration by Poland (*Official Journal C 160, 30/06/2005, p. 11-22*)

The term 'serious penalty' means penalty of fine, penalty of imprisonment or both of them imposed jointly, or penalty of deprivation of liberty for culpable infringement of tax law provisions by a taxpayer

Declaration by Portugal (*Official Journal C 160, 30/06/2005 P. 0011 – 0022)*

The term 'serious penalties' includes criminal penalties as well as administrative penalties applicable to tax infringements defined by law as serious or committed with intent to defraud.

Declaration by Romania (*Official Journal L 174, 03/07/2008 P. 0001 – 0005)*

The term 'serious penalty' includes the commission of any criminal act provided by the tax evasion law or the accountancy law or the company law or the tax legislation. It also includes administrative penalties in regard to:
- refusal to submit the tax statements (declarations) or the informative statements at the request of the tax bodies,
- refusal to supply documents and records requested by the tax inspection authorities,
- failing to submit the periodical financial documents and the accounting reports or, submitting such documents or reports which include incorrect data,
- actions included in the tax record, according to the legislation in force.

Declaration by Slovakia *(Official Journal L 174, 03/07/2008 P. 0001 – 0005)*

The term 'serious penalty' means a penalty imposed according to the Criminal Code for criminal offences committed with respect to the infringement of the pertinent tax laws, Tax Administration Act or Act on Accounting.

Declaration by Slovenia (*Official Journal C 160, 30/06/2005 P. 0011 – 0022)*

The concept of 'serious penalty' means a penalty for any infringement of tax law.

Declaration by Spain (*Official Journal L 174, 03/07/2008 P. 0001 – 0005)*

'Serious penalties' shall include administrative penalties for serious and very serious tax infringements, as well as sentences for offences affecting public finances.

Declaration by Sweden (*Official Journal C 026, 31/01/1996 P. 0001 - 0033)*

An infringement of the tax laws punishable by a 'serious penalty' is constituted by an infringement of the tax laws penalized by detention, criminal or administrative fines.

Declaration by the United Kingdom (*Official Journal L 225, 20/08/1990 P. 0010 – 0024)*

The United Kingdom will interpret the term 'serious penalty' as comprising criminal sanctions and administrative sanctions in respect of the fraudulent or negligent delivery of incorrect accounts, claims or returns for tax purposes.

ANNEX 6

Belgian contributions on the new Article 7 and the AC

A. Interaction between Article 4(2) of the EU Arbitration Convention and Article 7 of the Double Tax Agreements concluded between EU Member States

The EU Arbitration Convention establishes rules to resolve disputes where double taxation occurs between associated enterprises of different EU Contracting States as a result of an adjustment of the profits of one of those enterprises. The EU Arbitration Convention is a multilateral treaty concluded between the EU member states (Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises). For the purposes of the Convention, Article 1(2) deems a permanent establishment of an enterprise of a Contracting State situated in another Contracting State to be an enterprise of the State in which it is situated.

1. Article 4(2) of the EU Arbitration Convention

Article 4 of the Convention states the principles that must be observed in the application of the Arbitration Convention. According to Article 4(2):

"Where an enterprise of a Contracting State carries on business in another Contracting State through a permanent establishment situated therein, there shall be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment."

On the basis of the Arbitration Convention:

- A Contracting State may adjust the profits attributable to a permanent establishment according to the principles of Article 4(2).
- Under Article 6 an enterprise may present a case to the competent authority of the Contracting State in which its permanent establishment is situated where it considers that those principles are not observed by a Contracting State having adjusted the profits attributable to that permanent establishment.
- Article 6 commits the concerned competent authorities to endeavour to resolve the case by mutual agreement on the basis of the same principles.
- According to Article 11, the advisory commission must base its opinion on Article 4(2).
- Finally, the concerned competent authorities must, on the basis of the principles of Article 4(2), take a decision which will eliminate the double taxation.

The principles set out in Article 4(2) condition the application of the Convention at each level as of the taxation by a Contracting State until the final decision eliminating double taxation.

2. Principles applicable under bilateral tax treaties containing an Article 7 similarto Article 7 of the OECD Model Tax Convention as it reads before 22 July 2010

The text of Article 4(2) reproduces almost wholly the text of Article 7(2) of the OECD Model Tax Convention as it reads before 22 July 2010 (such text is included in most of the bilateral tax treaties concluded between the EU member States):

"2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment."

Article 4 does not contain the text of Article 7(3) of the OECD Model.

"3. In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere."

OECD has fundamentally changed the principle governing the attribution of profits to a permanent establishment in the Report entitled *"Attribution of Profits to Permanent establishments"*, which was approved by the OECD Committee on Fiscal Affairs in 2008.

The Report represents the outcome of the work on how the "separate arm's length enterprise" provision of Article 7 should be applied. The conclusions of the Report were implemented in the OECD Model Tax Convention in two stages.

The first stage was the revision of the Commentary on Article 7 as Article 7 reads before 22 July 2010. This stage was completed in the 2008 Update of the OECD Model. It was aimed at implementing the conclusions of the Report that do not conflict with the interpretation previously provided in the Commentary on Article 7.

Under the OECD Commentary on Article 7(2) updated in 2008, Sections D2 and D3 of Part I of the Report *"Attribution of Profits to Permanent establishments"* is applicable in order to determine the profits attributable to a permanent establishment, including the profits attributable to dealings with other parts of the enterprise (see especially paragraph 17 of thisCommentary).

The OECD Commentary on Article 7(3) updated in 2008 has clarified the general directive in relation to the expenses of a permanent establishment laid down in paragraph 2. It has endorsed the previous OECD Commentary with respect to intangible rights, services and

interest charges departing from the authorised OECD approach provided for in the Report *"Attribution of Profits to Permanent establishments"* (e.g. presumption that services which are related to the general management activity of the enterprise should normally be allocated at cost, no internal interest dealings in non-financial enterprises, no internal royalty dealings). To the extent that the Report contains some departures from what was previously said in the Commentary on Article 7(3), there was indeed a risk that Courts express doubts about the validity to interpret Article 7 on the basis of the whole Report, including those departures[6]

The second stage was the finalization of a completely new article 7 with related Commentary changes in the 2010 Update of the OECD Model.

3. Principles applicable under bilateral tax treaties containing an Article 7 similar to Article 7 of the 2010 Update of the OECD Model Tax Convention

The text of Article 7(2) of the OECD Model Tax Convention as changed on 22 July 2010 reads as follows:

"For the purposes of this Article and Article [23 A] and [23 B], the profits that are attributable in each Contracting State to that permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise."

The text of previous Article 7(3) is considered useless and is deleted.

The Report *"Attribution of Profits to Permanent establishments"* is wholly applicable under the new Article 7. The new Article goes further than before in treating the permanent establishment as a separate and independent enterprise and in recognizing the dealings between the permanent establishment and the other parts of the enterprise. It provides a greater level of consistency between the taxation of branches and the taxation of subsidiaries under tax treaties. For instance, under this new approach, dealings in the nature of a license provided by a head office (the economic owner of the intellectual property) to a permanent establishment that is using the intellectual property will be recognized. The notional license will give rise to a notional royalty from the permanent establishment to the head office and will reduce the profits of the permanent establishment by the amount of that notional royalty.

[6] The Vienna Convention on the Law of Treaties recognizes that practices that have been previously followed by tax administrations and that show that countries have agreed on a certain interpretation are relevant for the interpretation of a treaty provision (under Article 31(3), the context in which a treaty must be interpreted includes "(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation."

The separate and independent enterprise fiction (including the recognition of notional dealings and notional payments) is confined to determining the attribution of profits to a permanent establishment under Article 7 and Article 23 (Elimination of double taxation).

4. The arm's length principle applicable under Article 4(2) of the EU Arbitration Convention

The drafters of the Arbitration Convention have worded the arm's length principle similarly as it was generally worded, at that time, in the bilateral tax treaties but without referring to those treaties. This seems due to the lack of tax treaties between some EU member states and to the inconsistent wording of Articles 7(2) (and 9) in tax treaties.

The aim of the arm's length principle of Article 4(2) is to solve double taxation resulting from conflicting approaches within the European Union between tax administrations and between tax administrations and enterprises with respect to the attribution of profits to permanent establishments. In order to fully achieve that aim, the Contracting States, their competent authorities and the advisory commission should rely on a common interpretation of the arm's length principle on the basis of which the profits should be attributed.

The EU Arbitration Convention itself does not contain any substantive rules as to how the general "arm's length principle" it endorses should be understood. Consequently, it must be considered whether the Contracting States, the competent authorities and the advisory commission may freely decide the rules to be followed under the Arbitration Convention or whether they are bound to international rules when applying the Convention. If they are bound to international rules, those rules should be specified.

The assessment and the allocation of income between an enterprise of a Contracting State and its permanent establishment have to be based on the domestic laws of the Contracting States and also on the provisions of Article 7 of the tax treaty entered into by the concerned Contracting States and of Article 4(2) of the Arbitration Convention which are directly applicable. It is normally on that basis that an enterprise determines the dealings between the different parts of the enterprise and that tax administrations control those dealings. In this respect, the provisions of Article 7 of the concerned treaty and their interpretation are especially relevant in order to apply the Arbitration Convention[7].

The relevance of the tax treaty in force between the concerned countries in order to define the concept "at arms' length" is confirmed by Article 3(2) of the Arbitration Convention, which refers for any term not defined in the Arbitration Convention (and unless the context

[7] The Vienna Convention on the Law of Treaties recognizes that any relevant rules of international law applicable in the relations between the parties should be taken into consideration in interpreting a treaty provision (Article 31(3)(c)).

otherwise requires) to the meaning that the undefined term has under the tax treaty between the concerned countries.

Due to the divergences in the application of the profits attribution rules between states, enterprises face uncertainty as to whether the rules accepted in one state will subsequently be accepted in another state. In this respect, the OECD Commentary on Article 7 is of great assistance in the application and interpretation of that Article. Tax administrations and taxpayers give great weight to the guidance contained in that Commentary. Observations have sometimes been inserted at the request of some OECD Member countries that do not endorse an interpretation given in the Commentary. Those observations usefully indicate the way in which those countries will apply Article 7 of their tax treaties. The OECD Commentary has been approved by the representatives of the OECD Member countries (apart from some observations), and consequently is part of the international legal order that the EU member states should follow in order to comply with the legal basis of Article 4(2).

In this respect, the Revised Code of Conduct for the effective implementation of the Arbitration Convention provides that *"The arm's length principle will be applied, as advocated by the OECD, without regard to the immediate tax consequences for any particular Member State."* but does not specify if the arm's length principle advocated by the OECD should apply as revised from time to time (evolutionary interpretation) or not.

Different approaches can be followed in order to determine which rules shall apply to attribute profits to a permanent establishment.

Option I

The EU member states could agree that the principle "at arm's length" of Article 4(2) shall have the same meaning than the principle "at arm's length" of the Article on business profits included in the bilateral tax treaty concluded between the concerned states. Consequently, the tax administrations, the competent authorities and the Advisory Commission should take into consideration the interpretation given by the OECD Commentary on the provisions of Article 7 (including the observations of some states) corresponding to the provisions included in the concerned tax treaty.

The reference to the meaning of the concept "at arms' length" under a bilateral tax treaty shall imply that such meaning is taken into consideration even where the wording of Article 7 of the treaty differs from the wording of Article 4(2).

Examples:

Where the concerned treaty contains the provisions of Article 7(2) and (3) of the OECD Model as it reads before 22 July 2010, the principles of Article 4(2) will be interpreted on the basis of the OECD Commentary on Article 7 contained in the 2008 Update. This will be the case, even if such Commentary restricts the application of the Report "Attribution of Profits to Permanent establishments" by reason of the provisions of Article 7(3) which are not

included in Article 4(2) and even if, therefore, it could be argued that the Report should be entirely applicable in the context of Article 4(2).

Where the concerned treaty contains the provisions of Article 7(2) of the OECD Model as it reads in the 2010 Update, the principles of Article 4(2) will be interpreted on the basis of the OECD Commentary on Article 7 contained as of the 2010 Update. This will be the case, even if the wording of that provision is different from the wording of Article 4(2) and if, therefore, it could be argued that such Commentary should not apply.

Where the concerned treaty contains the provisions of Article 7(2) and (3) of the UN Model Double Taxation Convention, the principles of Article 4(2) will be interpreted on the basis of the UN Commentary on Article 7 that will be contained in the 2011 Update of that Model.

Where no treaty exists between the EU member states concerned by the application of the Arbitration Convention, the EU member states should expressly agree that the principle "at arm's length" of Article 4(2) has the same meaning than the principle "at arm's length" interpreted in the OECD Commentary as of the 2010 Update. As Article 4(2) does not contain the provisions of Article 7(3), the wording of Article 4(2) is large enough to cover all the rules provided for in the Report *"Attribution of Profits to Permanent establishments"*.

Those agreements could be included in the Code of Conduct for the effective implementation of the Arbitration Convention.

Advantages: Option I reconciles the rules governing the attribution of profits under bilateral tax treaties in force between the different EU member states and under the Arbitration Convention. It can be based on Article 3(2) of the Arbitration Convention.

Disadvantages: Option I endorses the application of two different sets of rules in order to attribute profits to a permanent establishment. Where several parts of an enterprise are situated in several states between which different treaty provisions are applicable, this option renders the attribution of profits to a permanent establishment more complicated and gives rise to mismatches.

Example:

An enterprise situated in State A has a PE in State B and a PE in State C. The tax treaty between State A and State B contains the new OECD Article 7 while the treaty between State A and State C contains the old OECD Article 7. A piece of software developed by the PE situated in State B is used by the PE situated in State C.

In order to determine the benefits attributable in States A and B to the PE situated in State B, the economic ownership of the software shall be attributed to the PE in State B and a notional royalty for the use of the software by the PE situated in State C shall be added to the benefits attributable to the PE situated in State B.

In order to determine the benefits attributable in States A and C to the PE situated in State C, a part of the actual costs of the development of the software shall be allocated to the PE situated in State C by reason of the use of the software by that PE and shall be deducted from the benefits attributable to that PE.

Option II

In order to achieve a uniform application of the principle "at arms' length" among all the EU member states, the member states could agree that the principle "at arm's length" of Article 4(2) has the same meaning than the principle "at arm's length" interpreted in the OECD Commentary as of the 2010 Update. As Article 1(2) deems a permanent establishment to be an enterprise of the State in which it is situated, the wording of Article 4(2) seems large enough to cover all the rules provided for in the Report *"Attribution of Profits to Permanent establishments"* based on the fiction that the permanent establishment is a separate and independent enterprise.

In order to achieve that goal, pre-eminence should be given to the Arbitration Convention in relation to the bilateral tax treaties that contain the old Article 7(2) and (3) of the OECD Model. In this respect, it can be argued that:

- Article 3(2) of the Arbitration Convention is not applicable to the meaning of the principle "at arm's length" of Article 4(2) because such application would go beyond the reference to the meaning of a term not defined in the Convention.
- Articles 3(2) and 15 of the Arbitration Convention imply that, except where the Arbitration Convention expressly provides otherwise, that Convention prevails over any treaty to which the Contracting States are or will become parties.
- It corresponds to the intent of the States having concluded the Arbitration Convention: they have included in Article 4 an autonomous definition of the principles "at arm's length" without referring to the corresponding principles included in Articles 7 and 9 of the bilateral treaties concluded between most of the EU member states; they have deemed a permanent establishment to be an enterprise of the State in which it is situated.

Advantages: Option II achieves a uniform application of the principle "at arms' length" among all the EU member states. It endorses the approach that most of the OECD member states have agreed to follow in the future.

Disadvantages: Some taxpayers could contest that interpretation where the applicable bilateral tax treaty contains Article 7(2) and (3) of the OECD Model as it reads before 22 July 2010.

Option III

In order to achieve a uniform application of the principle "at arms' length" among all the EU member states, the Arbitration Convention could be revised in order:

- to replace the text of Article 4(2) by the text of Article 7(2) of the 2010 OECD Update;
- to stipulate that the OECD Commentary on Article 7(2), as amended from time to time, shall be used in order to interpret such provision;
- to stipulate expressly that the provisions of the Arbitration Convention shall prevail over the provisions of a bilateral tax treaty.

Advantages: Option III provides more certainty with respect to the rules governing the attribution of profits under the Arbitration Convention and the pre-eminence of those rules over the rules provided for in bilateral tax treaties.

Disadvantages: Option III needs a lengthy procedure in order to be in force and applicable. The implementation of Option III is outside the mandate of the EU Transfer Pricing Forum.

B. Additional contribution submitted by Belgium:

In February, it was decided that the implications of the new Article 7 of the OECD Model should be explored further and members were invited to comment on document JTPF/006/BACK/2011/EN. Based on these responses it will be decided whether a sub-group could be set up to work further on this issue.

Following Article 1, the Arbitration Convention applies in order to solve double taxation *"on the grounds that the principles set out in Article 4 and applied either directly or in corresponding provisions of the law of the State concerned have not been observed"*. Consequently, a Contracting State must observe the principles set out in Article 4(2) to attribute profits to a permanent establishment for the application of its taxing rights.

In our view, different interpretations of the principles provided for in Article 4(2) are possible.

1. **Application of the OECD Transfer Pricing Guidelines, by analogy, for the purposes of determining the business profits attributable to a PE.**

As Article 1(2) deems a permanent establishment to be an enterprise of the State in which it is situated, the wording of Article 4(2) is large enough to cover all the rules provided for in the OECD Report *"Attribution of Profits to Permanent establishments"* based on the fiction that the permanent establishment is a separate and independent enterprise. One may consider that the rules applicable under this Report and the new Article 7 of the OCDE Model are applicable under the EU Arbitration Convention. This would imply possible conflicts with the rules provided for under many tax treaties in force between member states which include the old Article 7 of the OECD Model.

In this respect, it could, however, be argued that the Arbitration Convention is prevailing over any treaty to which the Contracting States are or will become parties (except where Article 15 is applicable). This seems to correspond to the intent of the States having concluded the Arbitration Convention: they have included in Article 4 autonomous principles without referring to the corresponding principles included in Articles 7 and 9 of the tax treaties concluded between member states; they have stated in Article 15 that the Convention shall not affect the fulfilment of "wider obligations" with respect to elimination of double taxation to which the Contracting states are or will become parties, which means that outside such "wider obligations" in tax treaties, the Arbitration Convention prevails over previous and later treaties.

2. Application of the rules provided for under the old Article 7 of the OECD Model

As the text of Article 4(2) reproduces almost wholly the text of Article 7(2) of the OECD Model Tax Convention as it reads before 22 July 2010, one may consider that the rules applicable under the old Article 7 of the OCDE Model remain applicable under the EU Arbitration Convention (as these rules have been interpreted in the OECD Model update of July 2008). This would imply possible conflicts with the rules provided for under later tax treaties between member states which include the new Article 7 of the OECD Model.

In this respect, it could, however, been argued that, except where Article 15 is applicable, the Arbitration Convention would prevail over any treaty the Contracting States have concluded before being parties to the Arbitration Convention but would only apply to the extent that its provisions are compatible with those of tax treaties concluded after that moment. In such case, the provisions of the new Article 7 included in later treaties would be applicable because Article 4(2) would not be fully compatible with those of the new Article 7.

3. Application of the principle "at arm's length" included in Article 7 of the tax treaty concluded between the concerned states (old Article 7 or new Article 7, as the case may be)

One could also consider that Article 3(2) of the Arbitration Convention is applicable to the meaning of the principle "at arm's length" described in Article 4(2), the meaning of which is not defined in the Convention. The reference to the rules governing such principle in tax treaties seems, however, to go beyond simply referring to the meaning that a term not defined in the Convention has under tax treaties.

Conclusion

The Contracting States should eliminate uncertainties by agreeing on a common understanding on the principles applicable under Article 4(2) of the EU Arbitration Convention and their interaction with Article 7 (Business profits) of the tax treaties between EU member States.

In this respect, a consensus on the interpretation mentioned under point 2 above seems foreseeable without further extended work and lengthy discussions.

Belgium would prefer an interpretation along the lines of point 1, which would result in a uniform application of the principle "at arms' length" among all EU member states by endorsing the approach that most of the OECD member states have agreed to follow in the future. At first sight, a consensus along these lines seems, however, more difficult to achieve.