

Resolving Transfer Pricing Disputes in Europe through Arbitration

Brian Cleave CB QC

International Tax Consultant

bcleave@lawdraft.fsnet.co.uk

Some history

- 1976 European Commission proposes Directives on Mutual Assistance in Tax Matters and on an Arbitration Procedure in Transfer Pricing Disputes
- 1977 Mutual Assistance Directive adopted by EC Council of Ministers
- 1977 Member States decide to discuss a multilateral convention on an arbitration procedure in place of a directive
- 1977 to 1990 Discussions on convention continue
- 1990 Convention signed by all Member States
- 1995 Convention enters into force for 5 years
- 1995 Three new Member States sign additional convention acceding to Convention

- 1999 Protocol signed extending convention by continuous periods of 5 years unless opposed by a Contracting State
- 2000 Convention expires before any case decided
- 2002 EU Commission sets up Joint Transfer Pricing Forum (JTPF)
- 2004 First case decided under arbitration procedure
- 2003 JTPF recommends Code of Conduct
- 2004 Extension convention and additional convention enter into force with effect from 2000
- 2004 Ten new Member States accede to Convention
- 2005 Code of Conduct adopted

Scope of Application of Convention of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (Article 1)

- Associated enterprises resident in Contracting States and their PEs
- Profits (or losses) of company in one CS included in profits (or losses) of company in another CS on grounds of breach of arm's length principle
- PE of enterprise of one CS situated in another CS deemed to be an enterprise of CS in which it is situated
- Taxes on income (Article 2)

Principles to be observed in the application of the Convention (Article 4)

1. Associated enterprises (replicates Article 9.1 of the OECD Model Tax Convention)
2. Enterprise and PE (nearly replicates Article 7.2 of the OECD Model)

Convention procedure: 4 phases

1. Adjustment of profits (Article 5)
2. Mutual agreement procedure (“MAP”)(Article 6)
3. Advisory commission (arbitration procedure) (Articles 7 to 11)
4. Decision of Contracting States (Article 12)

Phase 1: Adjustment of profits (Article 5)

- CS must inform enterprise of intended action in due time
- Opportunity for enterprise to inform the other enterprise
- Opportunity for the other enterprise to inform the other CS
- If all agree, that is end of the procedure

Phase 2: MAP (Article 6)

- Enterprise may present case to CS of which it is a resident (or where its PE is situated) within 3 years of “first notification” of action resulting in double taxation
- Must at same time notify CS of any other CS concerned in the case
- CS must then notify other CS
- CS must “endeavour to resolve the case by mutual agreement” with any other CS concerned with a view to eliminating double taxation on basis of Article 4 principles
- Compare Article 24 of OECD Model

Phase 3: Advisory Commission (Arbitration Procedure) (Article 7)

- If no mutual agreement within 2 years of date when case first submitted, CS must set up “advisory commission” charged with delivering its opinion on eliminating double taxation in question
- Where domestic law remedies sought, 2 year period dates from decision of final court of appeal
- CS not prevented from initiating judicial proceedings or proceedings for administrative penalties in relation to same matters
- CS by mutual agreement and with agreement of associated enterprises may waive time limits
- Associated enterprises may provide information, evidence or documents

Phase 3 continued (Articles 10 and 11)

- Enterprises and CS must give effect to request from Advisory Commission for information, evidence or documents
- Advisory Commission must deliver its opinion based on arm's length principle not more than 6 months after reference to it
- Adopts opinion by simple majority
- Costs other than those incurred by associated enterprises to be shared equally by CS concerned
- Double taxation regarded as eliminated if profits included in computation in one CS only or tax chargeable on them in one CS is reduced by tax chargeable on them in other CS

Phase 4: Decision of Contracting States (Article 12)

- CS parties to arbitration procedure must take decision on basis of arm's length principle eliminating the double taxation within 6 months of delivery of opinion of advisory commission
- May take decision deviating from commission's opinion
- If no agreement, must act in accordance with opinion
- CS may agree to publish decision with consent of enterprises

Composition of Advisory Commission (Article 9)

- Two representatives of each CS concerned (reduced to one by agreement between CS)
- Even number of “independent persons of standing” appointed by mutual agreement, or selected by drawing of lots, from list of 5 “competent and independent” persons nominated by each CS who are nationals of and resident in a CS
- Representatives of CS and independent persons of standing elect a Chairman from among persons on list who is qualified for appointment to highest judicial office in own country or is a “juristconsult of recognised competence”

Negative Aspects of the Convention

- Need for ratification by CS
- No automatic accession by new Member States
- Short duration
- Case could take 6 years to complete all 4 phases
- No body of case law likely to be developed
- No provision for appeals
- Enforcement of decision left to domestic law
- No ECJ jurisdiction to interpret Convention
- Lack of procedural rules
- CS not obliged to initiate procedure where one of enterprises is liable to serious penalties for actions giving rise to transfer of profits

Electrolux Case

- First case to complete all four phases – in 2003
- France and Italy were CS concerned
- MAP started in 1997
- France initiated arbitration procedure
- Setting up advisory committee took 18 months
- Taxpayer declined to take part
- Committee decided in favour of France by a majority (two dissenting votes)
- France and Italy failed to agree alternative solution
- Cost exceeded amount in issue (100,000 Euros)

Code of Conduct

- JTPF proposal built on work done by group of Member States
- Adopted by “representatives of governments of Member States meeting within the Council”
- Code has status of a “political agreement”
- Clarifies points at which time limits start
- Contains detailed provisions for conduct of mutual agreement and arbitration procedures
- Provisions for MAP also to apply to procedure under bilateral DTAs
- Suspension of tax collection during cross-border dispute resolution

Future of the Convention

- 10 new Member States have now ratified
- Second case now decided – France wins again
- More cases in pipeline, including two from UK
- Most procedural issues now resolved
- Interaction with administrative and judicial appeals only major issue outstanding
- Extend to other subjects e.g. thin capitalisation?
- EU Commission still wants a directive

Other Arbitration Provisions

- Over 60 bilateral double tax agreements provide for some form of arbitration
- Germany – Austria DTA (2000) (Article 25(5))
 - Applies to any issue involving double taxation
 - Appeals to European Court of Justice
- USA – Netherlands DTA (1992) (Memorandum of Understanding)
 - Depends on exchange of diplomatic notes
 - Sets out procedures in detail
- UK – Mexico DTA (1994) (Article 26(5))
- UK – Azerbaijan DTA (1994) (Exchange of Notes)

OECD Joint Working Group on Dispute Resolution

- Improving effectiveness of MAP
 - More transparency
 - Publication of national guidance
 - Production of OECD manual
 - Clarification of time limits
 - Removal of obstacles to MAP
 - Relationship with domestic law
 - Detailed proposals on conduct of MAP by CS
- Supplementary Dispute Resolution
 - Optional or mandatory
 - Advisory opinion
 - Arbitration