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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE

on the work of the EU Joint Transfer Pricing Forum in the period July 2012 to January 2014

1. INTRODUCTION

The global economic interdependence and the interaction of national tax rules can lead to double taxation or double non-taxation of multi-national enterprises. The Action Plan on Base Erosion and Profit Shifting ("BEPS Action Plan") presented by the Organisation for Economic Cooperation and Development (OECD) in July 2013 seeks to improve international tax rules and has received wide international support at the highest level. The Action Plan identifies several deficiencies in the existing international tax rules and standards, which can be exploited to erode the tax base in other jurisdictions and to shift elements of the tax base to reduce the overall tax bill.

From a European Union (EU) perspective, the existing gaps in international tax rules and standards hinder the smooth functioning of the Internal Market which encompasses 28 different tax regimes. The Commission considers it important to explore synergies between the current international debate on BEPS and discussions within the EU with view to establishing workable solutions within the EU, taking into account EU Treaty obligations, as well as to promote EU interests in the setting of international standards. The Commission also recognises that measures taken at EU level can contribute to achieving the objectives laid down in the BEPS Action Plan.

In the area of transfer pricing, multi-national enterprises (MNEs) and tax administrations (TA) are confronted with practical problems in pricing cross-border transactions between associated enterprises for tax purposes. The approach adopted by EU Member States to correctly evaluate the price of such transactions is that of the arm's length principle (ALP)[1]. The ALP is based on a comparison between the conditions applied by associated enterprises and the conditions that would have applied between independent enterprises.

However, the interpretation and application of the ALP varies – from one tax administration to another and between tax administrations and business. This can result in uncertainty, increased costs and potential double taxation or double non-taxation. These aspects impact negatively on the smooth functioning of the Internal Market.

The Commission set up in October 2002[2] the EU Joint Transfer Pricing Forum (JTPF), an expert group, to find pragmatic solutions to problems arising from the application of the ALP within the EU. The JTPF operates on the basis of four-year mandates, established through Commission Decisions. The present mandate of the JTPF runs until 31 March 2015.

The JTPF has been an important resource for the Commission's work on improving the practices of transfer pricing administration and functioning in the EU. It can also serve as a useful source of input to the G20 sponsored OECD BEPS project.

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[1] The arm's length principle is set forth in Article 9 of the Model Tax Convention developed by the Organisation for Economic Co-operation and Development (OECD MTC). The OECD has also developed Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

[2] Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: 'Towards an internal market without obstacles — A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities' COM (2001) 582 final, 23.10.2001, p. 21.

This Communication reports on the work of the JTPF in the period July 2012 to January 2014.

2. SUMMARY OF ACTIVITIES OF THE JTPF FROM JULY 2012 TO JANUARY 2014

In the period July 2012 to January 2014, the JTPF continued to implement its 2011-2015 work programme and met four times. Detailed reports were completed on three subjects – secondary adjustments, transfer pricing risk management and compensating adjustments. In parallel, the JTPF carried out several monitoring exercises. Ongoing projects of the JTPF include the monitoring of the practical functioning of Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises[3] (Arbitration Convention) and the revised Code of Conduct for the effective implementation of the Arbitration Convention[4], as well as the monitoring of the Code of Conduct on transfer pricing documentation for associated enterprises in the EU (EU TPD)[5].

The work of the JTPF as a whole has been consistent with the actions envisaged in the Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan). The newly adopted reports could inform possible revision of relevant provisions in the commentary to the OECD MTC and the Transfer Pricing Guidelines, while current work done by the JTPF on improving the practical functioning of the Arbitration Convention is relevant for the BEPS discussion on making dispute resolution mechanisms more effective (Action 14 of the BEPS Action Plan). BEPS work on transfer pricing documentation (Action 13 of the BEPS Action Plan) will also benefit from the findings of the JTPF in its ongoing review of the EU TPD.

2.1. JTPF Report on Secondary Adjustments (Annex I)

Transfer pricing legislation in some Member States allows or requires "secondary transactions" in order to make the actual allocation of profits consistent with the original transfer pricing adjustment ("primary adjustment"). Double taxation may arise due to the fact that the secondary transaction itself may have tax consequences and result in an adjustment ("secondary adjustment").

A JTPF questionnaire took stock of the situation across Member States as at 1 July 2011 and revealed that there are different legal provisions and practices with respect to secondary adjustments which may lead to double taxation within the EU.

The report presents the general aspects of secondary adjustments and gives recommendations on how to deal with possible double taxation in this context. Member States in which secondary adjustments are not compulsory are advised to refrain from making them in order to avoid double taxation. Member States in which secondary adjustments are compulsory are advised to provide ways and means to avoid double taxation. The recommendations, however, assume that the taxpayer is acting in good faith.

[3] OJ L 225, 20.8.1990, p.10.
[4] OJ C 322, 30.12.2009, p.1.
[5] OJ C 176, 26.07.2006, p.1.

Drawing on the EU Parent Subsidiary Directive (PSD)[6] the report recommends characterising secondary adjustments within the EU as constructive dividends or constructive capital contributions. Accordingly, the PSD ensures that no withholding tax is imposed on the distribution from a subsidiary to its parent within the EU.

For cases not covered by the PSD, the report describes and recommends the procedure of repatriation in the context of a Mutual Agreement Procedure (MAP) available under the respective applicable Double Taxation Agreement (DTA) or even at an earlier stage. Further it is recommended that Member States should refrain from imposing a penalty with respect to the secondary adjustment.

The recommendations in the report address most cases of double taxation arising from the different practices in MS with respect to secondary adjustments.

2.2. JTPF Report on Transfer Pricing Risk Management (Annex II)

Enforcement and compliance with transfer pricing rules can be resource-intensive for tax administrations and taxpayers respectively. The JTPF recognises that available resources for transfer pricing are limited and should therefore be deployed effectively. For this purpose, it is important to assess risks, address them effectively and have mechanisms in place to resolve disputes in an efficient and timely manner.

The report highlights that in addition to the legal and practical tools available, tax administrations and taxpayers in the EU can make use of special tools to manage transfer pricing. Such tools include exchange of information, common working procedures for audits in general, coordinated approaches on TP audits, a common documentation standard[7] and the dispute resolution mechanism under the Arbitration Convention.

The report builds on prior work on risk management done by the Commission[8] and other bodies such as the OECD[9] and puts it in the context of the special challenges of transfer pricing as well as the legal and administrative tools available within the EU.

The report contains guidance on managing transfer pricing risks based on the general principles of cooperation between taxpayer and tax administration(s), identification of high and low risk areas as well as well-targeted, timely and appropriate actions. For the phase prior to an audit the report recommends communication between taxpayer and the tax administration(s) at an early point in time and finding the balance between the need of tax administration(s) for information and the burden imposed on the taxpayer by requests for information. The report also recommends that Member States consider, in appropriate circumstances, exchanging information based on the EU Directive on Administrative Cooperation[10]. According to the Directive each competent

[6] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

[7] Code of Conduct on transfer pricing documentation for associated enterprises in the European Union (EUTPD), OJ C 176, 28.7.2006.

[8] European Commission: Risk Management Guide for Tax Administrations (2006) and Compliance Risk Management Guide for Tax Administrations (2010).

[9] OECD FTA Study "Dealing Effectively with the Challenges of Transfer Pricing" and OECD Draft Handbook on Transfer Pricing Risk Assessment.

[10] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, OJ L 64, 11.3.2011.

authority of a Member State may request relevant information from the competent authority of any other Member State. Competent authorities may also, at their own initiative, spontaneously share information they consider relevant for other competent authorities with those other competent authorities. Furthermore, tax administrations should have appropriate tools available to address high risk cases.

For the audit phase the report recommends to taxpayers and the tax administrations to achieve a mutual understanding of the facts and circumstances underlying the transactions under review at an early stage. It also recommends that MS consider, in appropriate circumstances, cooperative approaches within the EU on audits.

In the phase of dispute resolution, the report recommends efficient and timely resolution in the framework of MAPs and the Arbitration Convention.

2.3 JTPF Report on Compensating Adjustments (Annex III)

Compensating adjustments are transfer pricing adjustments "in which the taxpayer reports a transfer price for tax purposes that is, in the taxpayer's opinion, an arm's length price for a controlled transaction, even though this price differs from the amount actually charged between the associated enterprises"[11].

A JTPF questionnaire took stock of the situation in EU MS as at 1 July 2011 and revealed that MS have different practices with respect to compensating adjustments. The conditions, the procedures and the time to make such adjustments vary across MS and double taxation as well as double non-taxation may arise as a result.

The report aims to provide practical guidance on avoiding double taxation and double non-taxation that may result from different practices in Member States in the application of compensating adjustments. The guidance in the report is applicable to compensating adjustments which are made in the taxpayer's accounts and explained in the taxpayer's transfer pricing documentation.

The report recommends that Member States should accept a compensating adjustment initiated by the taxpayer (upward as well as downward adjustment), if the taxpayer has fulfilled certain conditions: the profits of the concerned related enterprises are calculated symmetrically, i.e. enterprises participating in a transaction report the same price for the respective transaction in each of the Member States involved; the taxpayer has made reasonable efforts to achieve an arm's length outcome; the approach applied by the taxpayer is consistent over time; the adjustment has been made before the tax return is filed; in case a taxpayer's forecast differs from the result achieved, the taxpayer is able to explain why this occurred, should it be required by at least one of the Member States involved.

2.4 Monitoring activity

An ongoing task of the JTPF is to monitor and manage the effective implementation of its achievements. This is done both by producing annual statistical reports and by preparing specific reports. The reports are then examined by the Commission and the JTPF to identify where further work by the JTPF could be carried out.

[11] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, Glossary (2010).

Statistical reports with respect to pending Mutual Agreement Procedures (MAPs) under the Arbitration Convention (AC) and on Advanced Pricing Agreements (APAs) are prepared and evaluated annually. The format of the statistics on pending MAPs under the AC has been recently improved and now allows better evaluation.

The comprehensive monitoring exercise which is currently being carried out on the practical functioning of the Arbitration Convention and its Code of Conduct has already resulted in concrete proposals for its improvement which are being discussed by the JTPF. The functioning of the EU TPD was monitored in 2013: MS and non-government stakeholders completed questionnaires on the impact of the EU TPD. The results will be discussed by the JTPF in 2014. Further to the Report on Small and Medium Enterprises (SMEs) and Transfer Pricing, information on transfer pricing relevant for SMEs was published in 2013 on the JTPF webpage for each MS.

3. COMMISSION CONCLUSIONS

The Commission continues to regard the JTPF expert group as a valuable resource in addressing transfer pricing issues and providing pragmatic solutions to a variety of such issues. The work of the JTPF is consistent with the actions envisaged in the BEPS Action Plan. The reports on secondary adjustments, transfer pricing risk management and compensating adjustments address key tasks identified by the Commission when setting up the JTPF and identified in the BEPS Action Plan.

The Commission fully supports the conclusions and suggestions of the Reports on Secondary Adjustments, Transfer Pricing Risk Management and Compensating Adjustments. The Commission invites the Council to endorse the Report on Secondary Adjustments and invites Member States to implement the recommendations in their national legislation or administrative rules. The Commission invites the Council to endorse the Report on Transfer Pricing Risk Management and invites Member States to implement practices that are in line with the approaches and procedural considerations contained in the report. The Commission invites the Council to endorse the Report on Compensating Adjustments and invites Member States to implement the practical solution recommended in the report.

The Commission believes that a future periodical monitoring exercise on the implementation of the reports' conclusions and recommendations will provide useful feedback to inform any necessary updating exercise.

The Commission encourages the JTPF to continue its monitoring activity and looks forward to the outcome of its current work on improving the practical functioning of the AC and the discussion on the Code of Conduct on transfer pricing documentation for associated enterprises in the EU. In the context of BEPS, once concrete solutions in the area of transfer pricing are agreed, the JTPF will consider ways to contribute to their consistent implementation within the EU.