The Implications of the Arbitration Convention
A step back for the European Community or a step forward for elimination of transfer pricing related double taxation?

Master Thesis in International Tax Law
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Abstract

It was assumed in the mid 1990s that 60% of all global trade took place within a group of enterprises. With increased globalisation leading to an increase in mergers and acquisitions this figure is most likely higher. Thus intra-company and intra-group transactions form a major part of business. These transactions, due to the association between the enterprises, may not always reflect the conditions that a market with independent actors would dictate. There are various reasons for this, which include not only tax considerations but also difficulties in establishing conditions that reflect those that independent companies would apply, in other words conditions in accordance with the arm’s length principle. In cases where these conditions are not in accordance with what the state considers as an arm’s length price, the profits of the enterprise located in that state may be adjusted for taxation purposes under transfer pricing provisions.

The complexity of transfer pricing rules and the various methods for establishing an arm’s length price result in different interpretations and increased uncertainty for multinational enterprises that often face different rules for determining a correct transfer price. Therefore, enterprises may often face transfer pricing adjustments of their profits due to the complexity and differences in transfer pricing legislation. Transfer pricing adjustments potentially lead to unresolved double taxation, in fact business reports have indicated that 42% of the transfer pricing adjustments lead to double taxation. Therefore it is imperative to have legal mechanisms that resolve potential double taxation.

The Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises (Arbitration Convention) was adopted to give the multinational enterprises, facing double taxation due to adjustments of their profits, a remedy that obliged the states to resolve the double taxation. This was the first, and is still the only, EC-wide mechanism that technically guarantees that transfer pricing double taxation is resolved and thus holds a great improvement over other existing mechanisms to resolve double taxation. The Arbitration Convention was originally a proposed EC Directive but was transformed into a intergovernmental convention. This has resulted in that the European Court of Justice (ECJ) has no jurisdiction to interpret the Arbitration Convention or its application. Furthermore there is no supranational or international organ that could take action against states that interpret or apply the Convention in an unintended manner. The chosen legal form has also resulted in different interpretations as to what status the Arbitration Convention has compared to bilateral tax conventions, and thus whether it precedes them. This could prove troublesome when future bilateral treaties are concluded or where there already exist tax treaties that have different solutions to transfer pricing related double taxation.

The risk of the Convention being interpreted differently is greatly increased by the various undefined terms and lack of precise provisions in the Convention. Therefore, the Convention has been subject to an inconsistent application and interpretation from the date it came into effect in 1995. The Convention was only given a five year life span, after which it was destined to be renewed if the contracting states so expressed, involving the same ratification process as at the initial acceptance of the Convention. However, as this was inefficient, a Prolongation Protocol was signed to amend the Convention with an automatic extension of its life. As it took till 2004 for this Protocol to be ratified and finally enter into force on 1 November 2004 it created one of the main interpretation and application differences in the life of the Convention.
The function of the Convention’s procedures and thus its efficiency in resolving double taxation is impeded by the numerous interpretation differences and lack of precise provisions in the Convention. The fact that there is no way to guarantee that the provisions of the Convention are precisely followed, partly since there are uncertainties regarding the precise interpretation but also partly since there is no organ that could enforce a uniform application of the Convention, further impedes the efficiency of the Convention, which is clearly seen in practice.

Another question of interpretation and application raised is that, although the Convention was originally intended as a means for resolving transfer pricing related double taxation, there have been arguments that the Convention could apply to double taxation due to provisions concerning thin capitalisation as well. These provisions bring about similar conditions as those the Convention requires for its applicability and, although a different area of law, the connections in the conditions are many and undeniable.
## List of Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tr>
<td>Arbitration Opinion Convention Convention</td>
<td>Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC)</td>
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<tr>
<td>Article (...) of the EC Treaty</td>
<td>Article (...) of the Consolidated Version of the Treaty Establishing the European Community</td>
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<td>Art.</td>
<td>Article</td>
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<td>BTR</td>
<td>British Tax Review</td>
</tr>
<tr>
<td>COM</td>
<td>Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee</td>
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<tr>
<td>EC</td>
<td>European Community</td>
</tr>
<tr>
<td>ECJ</td>
<td>European Court of Justice</td>
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<tr>
<td>EC Treaty</td>
<td>Treaty Establishing the European Community (Treaty of Rome)</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>ET</td>
<td>European Taxation (periodical)</td>
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<tr>
<td>ETR</td>
<td>European Tax Review (periodical)</td>
</tr>
<tr>
<td>IBFD</td>
<td>International Bureau of Fiscal Documentation</td>
</tr>
<tr>
<td>IL</td>
<td>Inkomstskattelag</td>
</tr>
<tr>
<td>ITPJ</td>
<td>International Transfer Pricing Journal (periodical)</td>
</tr>
<tr>
<td>MNE</td>
<td>Multinational Enterprise</td>
</tr>
<tr>
<td>MNG</td>
<td>Multinational Group</td>
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<tr>
<td>No.</td>
<td>Number</td>
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<td>OECD</td>
<td>Organisation of Economic Co-operation and Development</td>
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<td>op. cit.</td>
<td>opere citato</td>
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1 Introduction

1.1 Background

Unrelieved international double taxation of income between enterprises of Member States is contrary to the general objective of European Community to establish a well functioning internal market expressed in Articles 2 and 3 of the Treaty establishing the European Community (EC Treaty).\(^1\) The European Commission (Commission) therefore, on 29 of November in 1976, presented a proposal on a draft Directive for an arbitration mechanism for the elimination of double taxation resulting from adjustments made to enterprises’ profits by a Member State of the European Union (MS).\(^2\)

The adoption of the arbitration Directive was, however, held up, due to disagreement by the Council Working Party on Financial Questions and representatives from the MS on the legal basis and form of the proposed mechanism. The proposal was subsequently revised from a European Community (EC) Directive based on Article 94 of the EC Treaty to an intergovernmental convention based on Article 293 of the EC Treaty.\(^3\) The Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises (hereafter Arbitration Convention / the Convention) was signed by the Council on the 23 July 1990.\(^4\) There have been several consequences due to the chosen legal form and basis. The main issue is that the Arbitration Convention cannot be subject to supervision or interpretation of the Court of Justice of the European Communities (ECJ).\(^5\) This has allowed for differing interpretation of the Convention and its applicability.

The Arbitration Convention came into effect on 1 January 1995 after being ratified by all MS in 1994. A life span of five years was chosen, but in 1999 a Prolongation Protocol (Protocol) was signed for the amendment of the Convention to provide for an automatic extension after every five year period. This Protocol however, resulted in a lengthy ratification process, and even though it provided that it took effect from 1 January 2000, the application of the Convention was unclear during the ratification period. By agreeing to the Arbitration Convention, the EC Member States have expressively recognised the importance of eliminating international double taxation in connection with the adjustment of profits of associated enterprises.\(^6\) The Convention for this end provides for a procedure that binds the MS to resolve double taxation due to transfer pricing profit adjustments. However, interpretation and application differences have in reality impeded the efficiency of the Arbitration Convention.

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1 Articles 2 and 3 of the EC Treaty.


3 de Hert, Luc, A New Impetus for the Arbitration Convention?, ITPJ, 2005, No. 02, Article 1, pp. 50- 51.


5 de Hert, A New Impetus for the Arbitration Convention?, pp. 50- 51.

6 Preamble to the Arbitration Convention.
1.2 Purpose

The purpose with this thesis is to examine the applicability, interpretation and efficiency of the Arbitration Convention. It also clarifies the Convention’s relation to other legal acts. That is, what status it holds and if and how it takes precedence. There are six specific questions that this thesis analyses and answers within the scope of that purpose:

- The interpretation and application of the retroactive effect of the Convention, expressed in its Prolongation Protocol, during 1 January – 1 November 2004 and the differences in interpretation and application before and after this period and legal basis for the differences in interpretation.
- The legal status of the Convention and thus its relation to bilateral tax treaties that may include less far reaching or more far reaching obligations to eliminate double taxation.
- The possible application to double taxation due to thin capitalisation provisions.
- The interpretation problems with the procedures under the Convention, mainly focused on the expressed time limits, but also on the function of the advisory commission and an analysis of escape hatches due to provisions of inapplicability.
- What advantages and disadvantages the Convention has compared to other mechanisms generally existing today.
- Possible improvements to the Convention, including the author’s recommendations.

Aside of these specific questions to be analysed, and in order to do so, the thesis provides for an overall understanding of the Convention and therefore also describes and examines:

- The history of adoption, life span and chosen legal basis of the Convention and what impact the OECD Model Convention, Commentaries and Guidelines and national legislation may have for the interpretation and applicability of the Convention and its terms.
- The general scope of application of the Convention and exclusions from that scope.
- The procedure under the Convention.
- Other mechanism to resolve double taxation that generally exist today
- How the Convention has functioned in practice in the only case, to date, that has been settled under the last phase of the Convention.
- The work done by the Joint Transfer Pricing Forum (JTPF) in order to improve the Convention

The thesis will furthermore provide for a general explanation of incorrect transfer pricing adjustments and the problematic features and in what way transfer pricing provisions result in double taxation and what kinds of double taxation. This in order to show the need for a well-functioning mechanism that resolves transfer pricing related double taxation. For this, the Swedish legislation is explained in an overall manner to exemplify national transfer pricing legislation.

1.3 Method

The purpose of this thesis is achieved by applying traditional legal method, which is clarifying and interpreting the existing legal situation by means of legal materials. The thesis also researches non-legislative material in light of the legal area as a whole for a comprehensive and profound understanding. Where interpretation is done it applies traditional interpretation principles and methods expressed in the Vienna Convention on the Law of Treaties. For the non-legislative research the work done by the EC Commis-
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The International Bureau of Fiscal Documentation are the primary source. The non-legislative research also includes valuable previous research made.

1.4 Delimitation

This thesis does not intend to analyse transfer pricing and questions relating to it, it merely gives an explanation on how incorrect transfer pricing results in double taxation and the complexity of terms. Thus the methods for establishing arm’s length prices are not examined; it is for the scope of the thesis sufficient with a general description. The Swedish legislation is only intended as an illuminating exemplification of transfer pricing provisions and is not analysed. Interpretation of complex terms, as “associated enterprises” and “permanent establishment”, is not analysed. In the analysis of the Convention’s advantages compared to other general existing mechanisms those other mechanisms are only to be introduced in a general overall manner.

This thesis does not aim to analyse all interpretation and application problems with the Convention, the questions stated as the purpose are the questions for analysis and these have generally been the main issues with the Convention discussed both at Community level and by commentators. Not all problems regarding the interpretation, application and function of the Convention that are mentioned in the thesis are subject for analysis, rather they serve as a demonstration of uncertainties with the Convention, which motivates for the analysis of possible improvements. The possibility for appeals after the procedure under the Convention, or the re-opening of a case, or the possibilities for a state to withdraw from proceedings are not analysed. This because at current only one case has been settled under the arbitration phase of the Convention and therefore a possible appeal seems trivial compared to the importance of increasing the certainty of interpretation and function of the Convention.

1.5 Disposition

Chapter 2 provides for a general explanation of transfer pricing, what the reasons are for incorrect transfer pricing and how transfer pricing adjustments of enterprises’ profits potentially lead to international double taxation. It is imperative for the analysis that this explanation is given in order to provide for an understanding of the complexity and problems of this area. The chapter also gives a general explanation of thin capitalisation (thin cap) and how general thin cap provisions lead to double taxation. Although thin cap and transfer pricing are two separate legal areas they are introduced in the same chapter for clarity and practicality.

Chapter 3 provides for the history of adoption of the Convention, its life span and the accession of new Member States. It provides for research on the first question of the thesis, namely the retroactive effect of the Convention, expressed in its Prolongation Protocol and the differences of application before and after this period. It furthermore provides for research on the second question of the thesis; the legal status of the Convention. For this end, the legal basis that was chosen and its consequences are examined. The chapter also examines the Convention’s possible relation to other legal systems, which is not only important for the second question but also for the third.
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Chapter 4 examines the scope of the Convention, this in order to analyse the third question of the Convention; the possible applicability to thin cap related double taxation. The analysis of this question is localised entirely to the author’s analysis as it mainly involves the author’s own legal interpretation.

Chapter 5 examines the procedure set out in the Convention and introduces the problematic areas of it in order to research the fourth question of the thesis; the interpretation problems with the procedures under the Convention, mainly focused on the expressed time limits, but also the escape hatches due to provisions of inapplicability.

Chapter 6 provides for a presentation of the other mechanisms for resolution of transfer pricing related double taxation that generally exist today. This in order to analyse the fifth question: the analysis of the Convention’s improvements over these other mechanisms and to explain advantages and disadvantages of the Convention.

Chapter 7 researches the only case to date to have been settled using the advisory commission procedure under the Convention. As there are no known official publications of the opinion reached during by the advisory commission, the research will mainly focus on the discussions relating to it during meetings of the JTPF. This is important for the analysis of the fourth question, but will also have bearing on the analysis of the fifth question.

Chapter 8 provides for an introduction of the JTPF and its work to improve the Convention. This is important for the analysis of the fourth question and has bearing on the fifth question.

Chapter 9 provides for the author’s analysis of the stated questions in the purpose, including the sixth topic for analysis: the possible improvements of the Convention, including the author’s own recommendations.

Chapter 10 gives the overall Conclusions drawn in the thesis and also gives an answer to the title question; whether the Convention is deemed as a step backwards for the EC or if it is a step forward for the elimination of transfer pricing related double taxation.
2 Transfer Pricing and Double Taxation

The Arbitration Convention addresses double taxation issues that arise when the profits, that are included in the taxable profits, of an enterprise in a contracting state, are also included or likely to be included in the taxable profits of an enterprise of another contracting state.\(^7\) This chapter will explain how this scenario potentially arises from transfer pricing practices, (Swedish) national legislation and international legislation. This chapter provides for an illumination of the complexity of transfer pricing and where the problem, that the Arbitration Convention is to remedy, has its roots. The chapter also introduces the issue of thin capitalisation and double taxation that arises from thin capital practices. The part about the Swedish legislation is to serve as an example for how national transfer pricing regulations may take shape and how the need for the Arbitration Convention arises from that.

2.1 Intercompany and intracompany transactions

Intercompany transactions between companies and their subsidiaries, or between subsidiaries, and intracompany transactions between head offices and their branches, forming part of one group, are common and due to the existing relationship the transactions might not always occur under terms that they would between independent enterprises.

Independent enterprises that deal with each other, do so under financial and commercial conditions that are generally determined by external market forces. When associated enterprises deal amongst themselves the commercial and financial conditions of their relation might not be directly determined or affected by the external market forces.\(^8\) Even so, the financial position of the group of enterprises is indifferent to the prices set between the companies since one company’s gain will be reflected by the other’s loss. It is only when the goods or services leave the group that there will be an effect to the group’s financial position.\(^9\)

However, fiscally, this indifference to transfer pricing will not be true for multi-national groups (MNG) of companies. Differences in fiscal law and taxes levied in different national jurisdictions will affect the financial standing of the MNG, depending on how much is taxed and where.\(^10\) The total tax burden of the group and thus their after-tax revenue will ultimately be affected by the amount of tax levied on the different enterprises in the group.

2.2 Reasons behind incorrect transfer pricing

As enterprises form groups, the objective of maximising profits in each individual enterprise transforms to maximising the profits for the group as a whole. This shift in in-

\(^7\) Arbitration Convention, Art. 1.


\(^10\) op. cit. chapter 2.2.
terest will give the MNG an incentive to undertake internal transactions to allocate pre-tax profits and losses in order to minimise the tax burden.\textsuperscript{11}

There is a large variation in the tax burden faced by enterprises resident in different Member States.\textsuperscript{12} Thus multinational enterprises (MNE) will, when all enterprises in the group are profitable, be motivated to minimise their taxable profits in high-tax states and allocate profits to enterprises within the group in low-tax jurisdictions. The MNG will also, when there are enterprises with losses in the group, want to allocate profits to those enterprises, thus equalising the losses and reducing the taxable profits in the other enterprises of the group. Thereby the MNG avoids having to pay tax in some jurisdictions while the MNG as a whole might be suffering major losses. Transfer pricing can be used for this kind of profit shifting for tax planning purposes.

A simple example can illustrate how two associated MNEs could, in lack of transfer pricing legislation, use transfer pricing to allocate taxable profits in order to avoid taxation.

The Swedish enterprise X AB of the MNG will have a pre-tax profit of 375 000 Euro for the year 2006 while its German associated enterprise Y GmbH will have a loss of 270 000 Euro. If the MNG chooses not to make any transactions the Swedish enterprise will have to pay 28% corporate tax\textsuperscript{13} amounting to 105 000 Euro. The total profit of the MNG will thus be: 375 – 105 – 270=0. However, it is in the interest of the association to maximise the total profit of the MNG and thus the Swedish enterprise could choose to sell assets to Y GmbH charging a lower price than it would to an independent enterprise. The price paid by Y would be low enough to reduce the profit generated by X with 270 000 Euro and generating a 270 000 profit for Y. The German enterprise would thus be at a break-even point and the Swedish enterprise would pay 28% corporate tax amounting to 294 000. Thus the total profit of the MNG would be: 105 – 29,4 (+0)= 756 000.

Tax administrations should however not immediately assume that associated enterprises have sought to manipulate their profits. Even if associated enterprises seek to replicate market forces in their dealings with each other, there might be a genuine difficulty in accurately determining a market price in absence of external market forces or when adopting a commercial strategy.\textsuperscript{14} Associated enterprises in MNGs are generally considerably autonomous and even engage in bargaining with each other. Enterprises generally wish to achieve good profit records and would therefor be reluctant to engage in pricing conditions that would diminish their own profits.\textsuperscript{15} There are also other factors than tax considerations that may distort the conditions between associated enterprises.

\textsuperscript{11} Pelin, Lars, Internationell skatterätt i ett svenskt perspektiv, third edition, Lund 2004, p. 73.
\textsuperscript{12} COM (2001) 582 Final p. 7.
\textsuperscript{13} 65 Kap. 14§ II.
\textsuperscript{14} OECD Guidelines (2003) Chapter I Section A, para. 1.2.
\textsuperscript{15} OECD Guidelines, Chapter I, Section A, para 1.5.
2.3 The Swedish legislation on transfer pricing

As transfer pricing conditions within a MNG of enterprises have the potential to allocate taxable profits of an enterprise and thus diminishing a state’s tax revenues from that enterprise, there is national legislation for insuring the protection of the tax revenues of a state. The Swedish legislation on transfer pricing is found in Inkomstskattelagen (IL) (1999:1229), 14 kap. 19§ with a clarification found in 14 kap. 20§ IL.

It is a general principle that when affiliated enterprises conduct cross-border business they must do so according to market principles and act as if the business was conducted between independent enterprises. The transfer pricing charged on transactions has to follow the so-called arm’s length principle. In other words the affiliated enterprises should deal with each other as if they were independent, at arm’s length.\textsuperscript{16} The arm’s length principle is based on the separate entity approach, which states that each affiliated enterprise in a group is treated as a separate entity, taxed individually and with the notion that it does business with affiliated enterprises at arm’s length.\textsuperscript{17} The Swedish rules are based on these principles.\textsuperscript{18}

Where transactions not in accordance with the arm’s length principle, between associated enterprises, have decreased the taxable profits of a Swedish enterprise, and had these transactions not taken place between independent enterprises, the tax authorities may for taxation purposes adjust the accounts of the Swedish enterprise.\textsuperscript{19}

2.3.1 Rules for adjustment

The Swedish rules for adjustment are found in 14:19§ IL.

“\textsuperscript{19}§ If the result of an enterprise is reduced due to made conditions that deviate from what would have been made between independent subjects, the result shall be adjusted to the result they would have amounted to had the conditions not existed. This is valid only if:

1. the physical person or legal entity that due to the conditions receive a higher result shall not be taxed for it in Sweden according to the regulations in this law or due to tax treaties,

2. there are probable reasons to assume that the parties are associated, and

3. that it by the circumstances is not evident that the conditions are due to other reasons than association."\textsuperscript{20}

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\textsuperscript{18} Wiman, Bertil, Beskattning av företagsgrupper, Nordstedts Juridik AB, Stockholm, 2002, p. 91.

\textsuperscript{19} 14 kap. 19 § IL.

\textsuperscript{20} 14 kap. 19 § IL, author’s translation.
2.3.1.1 The two subjects

The application of the rule requires that there is a subject liable for Swedish corporate taxation that has had its results diminished due to transaction conditions with an other subject, which by the transaction has received higher results and is not liable for Swedish taxation. It is irrelevant for the application whether the subjects are physical or legal entities. The Swedish subject must be carrying on business whereas the foreign subject must not be liable for taxation of any kind for the transaction in Sweden, which expresses the international scope of the regulation and its inapplicability in a purely domestic situation. These criteria can be fulfilled either under Swedish legislation or due to limitations on national legislation by double taxation treaties. There is no requirement for the foreign subject to carry on business of any kind.

The fact that there has to be at least two subjects express the basic principle of contract law, that one subject can not enter into agreements or contracts with himself.\(^{21}\) This leads to the inapplicability of the rule to transactions between head offices and their branches.\(^{22}\) Since a branch is not considered to be an own subject but a part of the whole enterprise and thus not capable of contracting with the head office, incorrect transfer pricing between, for example, a Swedish head office and its foreign branch will not be able to be adjusted under 14:19§ IL.\(^{23}\)

2.3.1.2 Incorrect transfer pricing and the adjustment thereof

Although incorrect transfer pricing involves both overpricing and under-pricing of transactions, which lead to decreases or increases in corporate results, the rule only becomes applicable where there is a reduction of the results of the Swedish enterprise. If there is an incorrect transfer price that does not reduce the results of the enterprise, or in fact increases them, the rule does not apply. This is due to the purpose of the rule, which is to protect the Swedish tax base.\(^{24}\) If the incorrect pricing does not decrease the enterprise’s taxable profits the transaction does not decrease the Swedish tax revenues and thus the rule is inapplicable.

The incorrect transfer pricing conditions must further be due to the association between the parties, thus the rule also requires that the transactions deviating from the arm’s length principle are not justifiable by other considerations or business strategies than the association between the parties. The incorrect pricing must be due to the association. Some justifiable causes that have been accepted have been differing prices due to introduction on a new market or due to competition.\(^{25}\)

If all requisites are fulfilled the results of the enterprise will by the tax authorities be adjusted to the level they would have reached had the conditions followed the arm’s length principle. Thus the taxable profits are increased, or the losses decreased, with the


\(^{23}\) Skatteverket, Internprissättning, RSV Rapport 1990:1, p. 36.

\(^{24}\) Pelin, Internationell skatterätt i ett svenskt perspektiv, p. 74.

amount that the enterprise has reduced its accounts with, by the incorrect transfer pricing, and the corporate tax is calculated on this new tax base. These adjustments can be rather costly for the enterprise and the MNG.26 The adjustments can also be followed by penal sanctions.27 Of interest for this study is the fact that the adjustment can lead to double taxation where the adjustment in one state is not met by a corresponding adjustment in the other state. In that case the same profits will be taxed twice.28

2.3.2 Associated enterprises

The Swedish rule for clarification of what associated enterprise is in the meaning of 14:19§ IL is found in 14:20§ IL:

“20§ Associated enterprises referred to in 19§ exists where:

- an enterprise participates, directly or indirectly, in the management or control of another enterprise or owns part of that enterprise’s capital, or

- the same persons participate, directly or indirectly, in the management or control of both enterprises or own part of these enterprises’ capital.”29

All possible kinds of groups of enterprises should be within the scope of this rule and it is enough for the tax authorities to show that there are probable reasons to assume that there is an association for the criteria of association to be fulfilled. The incorrect pricing in itself could serve as an indication of association.30

The rule states that an association is at hand if an enterprise owns part of another enterprise’s capital or same persons own part of the capital in the enterprises. The amount of capital that the enterprise or persons need to own for an association to be at hand is not specified. Nor has it been specified in the laws preparatory works.31 Thus, literal interpretation of the law gives that any amount of owned capital will constitute an association.

According to the rule, an association is also at hand where one enterprise participates directly or indirectly in the control or management of the other or the same persons participate directly or indirectly in the control or management of both enterprises. The association can thus also be based on control or management. There are no definitions in the law what that means. Management could, however, refer to leading positions in the enterprise and the term control to voting powers at the shareholders’ meeting.32 Direct


27 Arvidsson, Richard, Dolda vinstöverföringar; En skatterättslig studie av internprissättningen i multinationella koncerner, Juristförlaget, Stockholm, 1990, p. 17.

28 See chapter 2.5.

29 14 Kap. 20§ IL. Author’s translation.

30 prop 1982/83:73 p. 11.

31 Arvidsson, Dolda vinstöverföringar; En skatterättslig studie av internprissättningen i multinationella koncerner p. 141.

32 Aldén, Nöjes, Om regelkonkurrens inom inkomstskattarätten – med särskild inriktning på förhållandet mellan olika grunder för beskattning av dolda vinstöverföringar till utlandet, Göteborg 1998, p. 124.
control should refer to parent-subsidiary enterprises and indirect control to shared management in the enterprises, that is that the same persons participate in the management of both enterprises.

The relations between creditor and debtor can lead to that a loan will be considered as grounds for an association.\textsuperscript{33} The associations discussed so far are based on formal affiliations, however, enterprises can also be informally associated. That is, for instance, when an enterprise only has one customer, which creates a relation where the customer can exercise a real control over the enterprise and the prices between the two get affected by their relation.\textsuperscript{34}

2.4 Organisation of Economic Co-operation and Development

Created as an economic counterpart to NATO, “the Organisation for Economic Co-operation and Development (OECD) is a unique forum where the governments of 30 market democracies\textsuperscript{35} work together to address the economic, social and governance challenges of globalisation.”\textsuperscript{36} It is a forum where governments can seek answers to common problems, identify good practice and co-ordinate domestic and international policies by implementing non-binding instruments.\textsuperscript{37}

One of the areas the OECD addresses is international taxation. The differences in nations fiscal legislation can lead to double taxation for multinational enterprises, which also constitutes a hindrance for fundamentals of the European Community; free movement of goods, services and capital.\textsuperscript{38}

The increased demand for a clear solution to the double taxation problem in international taxation matters, following the second world war and the resulting negotiations at the OECD on taxation and transfer pricing have paved the way for the OECD Model Convention on Income and Capital, which most countries use to establish bilateral tax treaties around the world. The first version of the model treaty was adopted in 1963.\textsuperscript{39}

\textsuperscript{33} Wiman, Beskattnings av företagsgrupper, p. 92.

\textsuperscript{34} Arvidsson, Dolda vinstöverföringar; En skatterättslig studie av internprissättningen i multinationella koncerner, p. 142.

\textsuperscript{35} Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States.

\textsuperscript{36} OECD homepage, The OECD: what is it? \url{http://www.oecd.org/document/18/0,2340,en_2649_201185_2068050_1_1_1_1,00.html}, 2006-03-10.

\textsuperscript{37} Ibidem.

\textsuperscript{38} Art. 3 EC Treaty.

2.4.1 The OECD Model Convention on income and capital

As explained, national competent authorities counter transfer of profits or losses by the use of incorrect transfer pricing by adjusting the taxable profits of the enterprise as if the transactions had been performed at arm’s length price. The competent authorities can do this under national legislation, but they can also derive this right from international double taxation treaties modelled on the OECD Model Convention. In the Model Convention the competent authority’s right to adjust the enterprise’s profit and the arm’s length principle is given under article 9.1:

“Where

a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.”

The scope of this article is adjustments to enterprises’ profits for tax purposes, where transactions have been entered into between parent and subsidiary companies or companies under common control on other than arm’s length terms. Hence, unlike the Swedish legislation, both parties must be enterprises; juridical persons or physical persons carrying on an enterprise.

When the relationship between the affiliated enterprises involved in the transfer pricing issue is that of an enterprise and its permanent establishment the competent authority is given the right to adjust by article 7.2:

“(…), where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment the 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.”

The paragraph contains the directive on which the allocation of profits to a permanent establishment is to be based. It states that the profits to be attributed to a permanent establishment are those which the permanent establishment would have made if it, instead of dealing with its head office, had dealt with an separate enterprise according to market

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40 OECD Model Convention, Art. 9(1).
41 OECD Commentary on Art. 9, para 1.
42 OECD Model Convention, Art. 7(2).
conditions and prices, thus it corresponds to the arm’s length principle expressed in article 9.1.\textsuperscript{43}

The OECD arm’s length principle is based on the separate entity approach, treating each enterprise in a group as a separate, independent enterprise\textsuperscript{44}. Each associated enterprise in an MNG is for the purpose of taxation treated as a separate entity and taxed individually on the basis that it conducts business within the group at arm’s length.

The effect of these articles depend on provisions in national legislation as they are not self executing. The Model Convention is not in itself an international treaty, it is a model which is by the Council of the OECD recommended for the OECD Member states to follow when concluding tax treaties.\textsuperscript{45} If there is no law under a nations domestic law that allows for transfer pricing adjustments the tax treaty will not give the tax authorities that right either. This in accordance with the principle that a double taxation treaty can only restrict a nations taxation rights, never extend them.

\textbf{2.4.2 OECD Transfer Pricing Guidelines}

The Committee on Fiscal Affairs, which is the main tax policy body of the OECD has issued a number of reports addressing transfer pricing and other related tax issues concerning MNEs. The Guidelines are a revision and compilation of those previous reports.\textsuperscript{46}

The Guidelines provide for an overall transfer pricing framework in all EU Member States and form a common set of generally applied “rules”. However, the Guidelines are not clear in all aspects and leave room for different use and interpretation by Member States and businesses.\textsuperscript{47} The Guidelines also establish and describe various methods to be used for the determination of what constitutes an arm’s length price.

The Guidelines focus on the application of the arm’s length principle to evaluate the transfer pricing of associated enterprises and thus intend to help tax authorities and MNEs by indicating ways of reaching mutually satisfactory solutions.\textsuperscript{48} They thereby also minimise the need for costly and time consuming litigation due to conflicts between tax administrations in different states and between tax administrations and MNEs. The Guidelines analyse methods for evaluation of whether the business relations in MNG follow the arm’s length principle.\textsuperscript{49}

\textsuperscript{43} OECD (2003) Commentary on Art. 7, section II para. 11.

\textsuperscript{44} OECD Guidelines, Preface point 5 and point 6.


\textsuperscript{46} OECD Guidelines, Preface, paras. 10 and 13.

\textsuperscript{47} Commission Staff Working Paper, SEC(2001) 1681, p. 265

\textsuperscript{48} OECD Guidelines, Preface para. 15.

\textsuperscript{49} Ibidem.
The Guidelines also intend to govern the resolution of transfer pricing issues in mutual agreement procedures between OECD member countries. It also provides guidance when a request for a corresponding adjustment has been made.\(^{50}\) The first mentioned aspect of the Guidelines will be further analysed under chapter 6.

The Guidelines are not binding, but the OECD encourages its member countries to follow the Guidelines in their domestic transfer pricing practices and also encourages taxpayers to follow the Guidelines to evaluate whether their transfer pricing complies with the arm’s length principle. The Guidelines also give interpretation to the arm’s length principle and are intended to govern proceedings for the resolution of double taxation provided for in the Model Convention.\(^{51}\)

### 2.5 Adjustments lead to international economic and juridical double taxation

Where an enterprise of a state has adopted transfer pricing not in accordance with the arm’s length principle and thus has decreased taxable profits, the results of the enterprise will by the national tax authorities be adjusted to the level the results would have reached had the conditions followed the arm’s length principle. Thus the taxable profits are increased, or the losses decreased, with the amount that the enterprise has reduced its accounts with, by the incorrect transfer pricing, and the corporate tax is calculated on this new tax base.

This adjustment can lead to a double taxation of the profits for the MNG. Such double taxation due to transfer pricing occurs when the tax administration of one state unilaterally adjusts the price put by an enterprise on a cross-border intra-group transaction, without this adjustment being offset by a corresponding adjustment in the other Member State or States concerned.\(^{52}\) This adjustment procedure can be illustrated by the following model:

\[^{50}\text{Op. cit, Preface, para 17.}\]
\[^{51}\text{Op. cit, Preface, paras. 16 and 17.}\]
\[^{52}\text{COM (2001) 582 Final p. 39.}\]
As seen in the example the MNG will now be taxed twice on the 270 000 if there is no corresponding adjustment in state 2.

Where the tax administration makes an upward adjustment of the taxable profits the MNE is immediately subject to double taxation. This double taxation can be relieved only if the tax authorities of the other state accept a corresponding downward income adjustment, or if the tax authority of the first state subsequently reverses the adjustment.53

2.5.1 Economic double taxation

Where the two enterprises involved are parent and subsidiary or two subsidiaries, the adjustment and the lack of corresponding adjustment will lead to economic double taxation. Economic double taxation is the term used to describe the situation where two different persons are taxable in respect of the same income or capital.54 This arises when an enterprise of a state whose profits are revised upwards will be liable to tax on an amount of profit which has already been taxed in the hands of its associated enterprise in another state.55

The Swedish rules under 14:19§ IL are not applicable when an MNE in Sweden increases its results by applying incorrect transfer pricing.56 Since the rules of adjustment only concern situations where a domestic enterprise of an MNG has decreased its profit, they contribute to the possibility of double taxation arising. If the state where the enterprise has its associated enterprise has similar rules and the enterprise in that state receives a lower profit due to transfer pricing not in accordance with the arm’s length principle, that state will adjust the accounts of that enterprise. However, since the Swedish national rules do not apply to situations where the profits of the domestic enterprise have increased due to the incorrect transfer pricing, there will be no national legislation or incentive for the decrease of the taxable profits in Sweden with a corresponding adjustment. Thus there will be a situation where the same profits are taxed twice: on the one hand the fictive, adjusted profits in the other state and on the other hand the actual profits in Sweden. In the authors view this should be true in most states since it is unlikely that there is national legislation that obliges tax authorities to invest resources in the investigation of a transfer pricing issue in order to reduce the taxable profits, hence the tax revenues for the state.

Unlike the Swedish national legislation, the OECD Model Convention does provide for a corresponding adjustment, which is expressed in article 9.2 of the OECD Convention.

“Where a Contracting State includes in the profits of an enterprise of that State – and taxes accordingly – profits on which an enterprise of the other Contracting State has been charged to tax in that other state and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made

54 OECD Commentary on articles 23 A and B, section I, para 2.
55 OECD Commentary on Art. 9, para. 5.
56 14:19§ st. 1, IL.
between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the taxes charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this convention and the competent authorities of the Contracting States shall if necessary consult each other." 57

Thus article 9.2 obliges the tax authorities of the second state to make a corresponding adjustment to the taxable profits of the enterprise whose profits have been adjusted in the first state. However, such a corresponding adjustment is not automatically to be made simply because the profits in the first state have been increased; the adjustment is only to be made if the second state considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm’s length. Thus the article is not to be invoked where the profits of one associated enterprise are increased to a level which exceeds what they would have reached if they had been computed correctly on an arm’s length basis. The second state is therefore only committed to make a corresponding adjustment if it considers the adjustment made by the first state to be justified in both principle and amount. The corresponding adjustment is not mandatory because a tax administration should not be forced to accept the consequences of an arbitrary or capricious adjustment by another state and, thus, also to maintain the fiscal sovereignty. 58 The article also recommends that competent authorities consult each other if necessary to determine corresponding adjustments. This demonstrates that the mutual agreement procedure under article 25 may be used to achieve corresponding adjustments. 59 However, the mutual agreement procedure under article 25 is not a guarantee either. This mutual agreement procedure is further analysed under chapter 6.2.

2.5.2 Juridical double taxation

Where the transfer pricing adjustment involves a head office and its branch, the adjustment and lack of corresponding adjustment will result in juridical double taxation. Juridical double taxation is the imposition of comparable taxes in two, or more, states on the same taxpayer in respect of the same subject matter and for identical periods. 60 This arises when the profits generated by a branch in one state also are included in the profits of an enterprise, located in a second state, to which the branch belongs and are taxed in both states. 61

As the Swedish rules for transfer pricing adjustment do not apply to enterprise and branch relations, they do not cause juridical double taxation. However, if an other state in which the Swedish branch is located does have legislation for the adjustment of transfer pricing between branch and enterprise, the Swedish transfer pricing legislation will,

57 OECD Model Convention, Art. 9(2).
59 OECD Guidelines, chapter IV, section C, para. 4.33.
as in the case of economic double taxation, not provide for a corresponding adjustment for the enterprise located in Sweden, thus leading to juridical double taxation.

The OECD Model Convention does, unlike in the case of economic double taxation, not provide for a direct remedy to the juridical double taxation through a corresponding adjustment. The only possibility is under article 25, this is further analysed under chapter 6.2.

2.5.3 Further causes of double taxation

Business reported in the 1999 Ernst & Young Transfer pricing survey that in 42% of cases of adjustment of profits this resulted in double taxation.

2.5.3.1 Lack of double taxation treaties and binding resolution

The lack of a double taxation treaty between the states can lead to double taxation due to transfer pricing adjustments, since there might not be any grounds for a corresponding adjustment under the domestic legislation.

Even if there is a double taxation treaty modelled after the OECD Model Convention, the parties might not have adopted article 9.2 in the treaty. The absence of this article in a double taxation treaty between two states means that a corresponding adjustment is not likely to be made, especially if there are no unilateral domestic provisions to that effect, and the profits in question will thus be included in both taxpayers’ taxable profits. If the two states have not included article 9.2 in their treaty, article 25 may be used to consider corresponding adjustment requests.

However, as explained, even with article 9.2 the tax authorities of the state making the corresponding adjustment only need to make the adjustment if they agree on the primary adjustment in principle and amount. If they do not agree, article 25 provides for a possibility for a mutual agreement procedure between the tax authorities and a possibility to resolve the double taxation. See further chapter 6.2.

2.5.3.2 Conflicting interpretations of the arm’s length principle

Transfer pricing regimes in Member States are not identical and enterprises can therefore be subject to as many different transfer pricing systems as the number of states they operate in. Since transfer pricing is a “two-way” exercise, the difference in transfer pricing rules will cause disputes between Member States and potential double taxation for enterprises.

National tax authorities may adopt different transfer pricing methods or combinations thereof to establish arm’s length prices. Due to the substantial divergences in the appli-

cation of the transfer pricing methods between states and the implementation of the OECD Guidelines, business face uncertainty as to whether the transfer prices accepted in one state will subsequently be accepted in another.\textsuperscript{66}

\subsection*{2.5.3.3 Conflicting classification of Permanent Establishments}

States may have different views on whether a place of business, through which the business of an enterprise is being conducted, should be classified as a permanent establishment for tax purposes, and whether a company should be considered resident in a given state or not. Conflicting definitions of permanent establishments and company residency constitute another cause of double taxation.\textsuperscript{67}

The OECD Model Convention does not settle the dispute between the taxpayer and the state claiming the right to tax branch profits. It is a matter for the domestic courts to decide whether a permanent establishment has been established.\textsuperscript{68}

The Model Convention also lacks provisions for corresponding adjustments due to transfer pricing adjustments between branch and enterprise and these can thus only be resolved under article 25.

\subsection*{2.6 Thin Capitalisation}

Thin capitalisation of enterprises is a term describing the case when the debt of the enterprise is disproportionately large compared to the equity of the enterprise, thus a situation of low solvency.\textsuperscript{69}

When a subsidiary has low equity, thin capitalisation, and otherwise only loans from its parent company or loans where the parent company is guarantor, to finance itself, there might be implications that this arrangement is made for fiscal reasons and that such arrangements would not have been made between independent enterprises.\textsuperscript{70}

Where an enterprise owns part of another enterprise it may receive dividends on its shares. These dividends are paid from the enterprise’s taxed profits and are generally not deductible from the taxable profits. The dividends are generally also taxable at the level of the receiver, hence a situation of economic double taxation. However, if instead the first-mentioned enterprise was to give loans to the second enterprise, it will receive interest on these loans. The interest is paid from the taxable profits and thus deductible and reduces the tax on the profits. The interests will then form part of the receivers taxable profits and thus be taxed only at that level. The deductibility of interest payments

\textsuperscript{66} Communication From the commission to the council, the European Parliament and the economic and social committee COM (2001) 582 Final p. 39.


\textsuperscript{68} Ibidem.


\textsuperscript{70} Dahlman \& Fredborg, Internationell beskattning - En översikt, p.67.
may be an incentive for associated enterprises to keep as high dept in a subsidiary as possible.\textsuperscript{71}

In these cases where the dept of a subsidiary is disproportionately large and the equity of the subsidiary has been made inadequate for its needs due to association between enterprises, some jurisdictions may not allow the interest payment to be deductible. In that case the undercapitalised enterprise’s taxable profits are adjusted upwards with the amount of interest that is not deductible.\textsuperscript{72} A large number of states also have legislative rules that express that some part of the debt should be considered as the subsidiary’s equity and thus interest payments on that part would be considered as dividends. Such dividends would thus no longer be deductible for taxation purposes as interest but be taxed. The parent company might also under the national legislation of the indebted enterprise’s state be liable for taxation on dividends from that state.\textsuperscript{73}

The fact that the parent company will in its own state generally also be liable for taxation on interest incomes, the adjustment of the subsidiary’s taxable profits will lead to the same profits, the interest, being taxed twice in the hands of the two enterprises, in other words economic double taxation. If the subsidiary’s state also taxes the parent company for dividends this will also lead to juridical double taxation as the parent company is taxed twice; first dividend tax on the re-classified interest payments in the subsidiary’s state and second, taxation on the received interests in its own state.\textsuperscript{74}

It is mainly the state where the indebted enterprise resides that has reason to strike down at thin cap arrangements since it is the indebted enterprise’s taxable profits that are completely or partly transferred to the creditors state when the creditor claims the interest on the debt, interest that, unlike dividends, is deductible for the debtor.\textsuperscript{75}

In Sweden the Supreme Administrative Court has tried the issue of thin capitalisation in RÅ 1990 ref. 34 and stated that there is no specific fiscal legislation concerning the situation where an enterprise’s equity is unusually low compared to its debt. Thus the preceding view cannot be enforced under Swedish legislation.\textsuperscript{76}

Some states have issued so called debt-to-equity ratio requirements, where interest payments are denied deductibility if a certain ratio between equity and debt is crossed. Germany for instance has a requirement of 1,5:1 (3:1 for holding companies) thus if the debt is 1,5 times the equity, interest payments on the exceeding debt are not deductible.\textsuperscript{77}

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\textsuperscript{71} Peter Brandt, Internationella Skattefrågor – inverkan av skatteavtal och EG-rätten på underkapitaliseringsfrågor, SkatteNytt nr. 5 1997, online in FAR Komplet Database, downloaded 2006-03-01
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\textsuperscript{72} Ibidem.
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\textsuperscript{73} Dahlman & Fredborg, Internationell beskattning - En översikt p.67.
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\textsuperscript{74} Brandt, Internationella Skattefrågor – inverkan av skatteavtal och EG-rätten på underkapitaliseringsfrågor, FAR Komplet, downloaded 2006-03-01.
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\textsuperscript{75} Op. cit. pp. 2.
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\textsuperscript{76} see RÅ 1990 ref. 34.
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\textsuperscript{77} Tivéus & Köhlmark 2001, p. 151.
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According to OECD Commentaries to the Model Convention, article 9 is relevant not only in determining whether the rate of interest provided for in a loan contract is at arm’s length rate, but also whether a loan can be regarded as a loan or should be regarded as other kind of payment, in particular a contribution to equity capital. Thus a state can also derive the right to make adjustments from taxation treaties modelled on the Model Convention, if of course there is domestic legislation to the same effect.

The OECD Model Convention does not, however, specify any corresponding adjustment to be made in the state of the enterprise that receives the interest payments. Thus the resolution of the double taxation due to the adjustment is left to article 25. See chapter 6.2

2.7 Conclusions

As explained in this chapter there are generally no national regulations for the abolition of double taxation due to transfer pricing adjustments. The corresponding adjustment under article 9.2 is not always included in the tax treaties and even if it is included it does not force out a solution to the double taxation through a corresponding adjustment, thus in no way a guarantee for avoidance of double taxation.

There might be a genuine difficulty for an MNG to accurately determine a market price in absence of external market forces or when adopting a commercial strategy and thus the transactions between associated enterprises might not reflect the arm’s length prices. This does not mean that the MNG has tried to manipulate the profits, it can be a simple difficulty. The complexity of the arm’s length principle and the practical methods for determining a correct arm’s length price may also lead to differing results on what an arm’s length price is from state to state. As was seen there may be differences in interpretation of where transfer pricing rules apply, the Swedish national law does, for instance, not apply to branch and head office relations whereas the OECD Model does and the complexity of determining what constitutes an association and what constitutes a permanent establishment may also lead to different application of transfer pricing rules. The same differences exist in different states’ legislation and may result in adjustments that the other state will not agree with and thus not make a corresponding adjustment. Simply said, the complexity and differences in national legislation on the area may lead to differing conclusions of what constitutes a transfer price at arm’s length and in which situations to make adjustments and corresponding adjustments. These differences may lead to unresolved double taxation. As has also been examined, thin cap legislation is another area that potentially will lead to double taxation and is considered to be within the scope of the OECD Model’s arm’s length principle. This area is in the author’s opinion subject to the same uncertainty as transfer pricing due to differing national legislation, and as seen sometimes no legislation.

As stated a high percent of adjustments lead to double taxation of corporations. Double taxation is an obstacle for international business and an impediment for the EU internal market. Thus it is imperative to have appropriate dispute settlement mechanisms that relieve double taxation as quickly, efficiently and in as many cases as possible, and with the lowest possible costs for business and tax administrations.

3 The Arbitration Convention - The Process of Adaptation

“The use of arbitration to solve taxation disputes will not only lead to cost-effective and equitable resolution of tax controversies, but also the enhancement of global economic growth and development through elimination of unintended instances of double taxation.” 79

As concluded in the proceeding chapter, double taxation due to transfer pricing adjustments is a great problem for MNEs and it is the problem that the Arbitration Convention is designed to solve. This chapter will explain the history and legal basis of the Convention and questions and problems that have arisen from the chosen legal basis. This is necessary for the analysis of the Convention, its applicability and the discussion on possible improvements. It will illuminate the first question of the thesis; the applicability and retroactive applicability of the Convention between 1 January 2000 and 31 December 2004. The chapter will further analyse what other legal instruments may have effect on the applicability of the Convention, as this is important for analysing the third question of the thesis; the Convention’s applicability to double taxation arising from thin capitalisation. It will also examine expressed interpretations on whether the Convention is to be seen as a supranational or international legal act, to determine its ranking, which is important for the second question.

3.1 History

It was generally assumed in the mid 1990s that 60% of all global trade took place intragroup. Increased globalisation implies that this figure is now even higher. 80 The Community must therefore realise the importance of transfer pricing tax problems of intra-community transactions between EC based associated enterprises.

Unrelieved international double taxation of income between enterprises of Member States is contrary to the general objective of European Community to establish an internal market expressed in articles 2 and 3 of the EC Treaty. 81 The need for a resolution to the double taxation problem was recognised almost 30 years ago in the Preamble to the 1976 commission’s proposal for an arbitration Directive. 82

On 29th of November in 1976 the European Union Commission presented this proposal on a draft Directive on an arbitration scheme to settle double taxation disputes, follow-

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The Implications of the Arbitration Convention

...ing its 1975 action programme, which involved work on a proposal on the elimination of double taxation resulting from adjustments made to profits by a Member State. 83

The proposed Directive was to complement the proposal for a Directive for mutual assistance in taxation measures, and the Commission stressed the close link between the two Directives since the introduction of a system for the tax authorities to exchange information could potentially increase the cases of double taxation, especially in regards to transfer pricing. The Commission’s view was that the Arbitration Directive should be adopted simultaneously with the Mutual Assistance Directive 84 in order to ensure a remedy for instances of double taxation. 85

However, the adoption of the Arbitration Directive was held up, inter alia because the Council Working Party on Financial Questions did not agree with the legal basis for the Arbitration Directive, namely article 94 of the Treaty on the European Communities (EC Treaty). The Council was of the opinion that the objective of the proposed Directive should fall within the scope of article 293 EC. The Committee of Member State’s Permanent Representatives to the European Union agreed with the reservations and that the proposal should rather be based on article 293. 86 Thus the proposed Directive was transformed to a proposal for an intergovernmental convention. A convention would make less of an infringement on the Member State’s fiscal sovereignty which, also given the lack of common set of transfer pricing rules, the MS’s where reluctant to surrender. 87 “The legal form was a political decision made by Member States, which has been based on the collective hesitation to surrender a significant part of their fiscal sovereignty as there had not been any common rules on transfer pricing.” 88 An additional argument was that a convention has the advantage that it is not necessary to implement its provisions into national legislation, as is the case with a Directive, and thus a convention would have the same application in all MS, although the Convention is drawn up in all the languages of the Member States. The main effect of the change from Directive to convention was that the Arbitration Convention would not be subject to supervision or interpretation of the Court of Justice of the European Communities (ECJ). 89

The Council signed the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (Arbitration Convention) on 23


86 de Hert, A New Impetus for the Arbitration Convention?, pp. 50- 51.


89 de Hert, A New Impetus for the Arbitration Convention?, p 50- 51.
July 1990.\textsuperscript{90} The Convention, being an intergovernmental instrument needed ratification by all then 12 Member States.\textsuperscript{91} Article 17 of the Convention expresses this need for ratification. The Convention could enter into force on the first day of the third month following that in which the instrument of ratification is deposited by the last signatory State to take that step.\textsuperscript{92}

The Arbitration Convention came into effect for five years on 1 January 1995 after being ratified by all MS in 1994. By agreeing to the Arbitration Convention, the EC Member States have recognised the importance of eliminating international double taxation in connection with the adjustment of profits of associated enterprises.\textsuperscript{93}

### 3.1.1 Accession of new Member States

In 1995 the European Union expanded with the accession of Austria, Finland and Sweden. Since the Arbitration Convention has the form of a separate agreement, accession to the European Union does not automatically include accession to the Convention. The three new and twelve old Member States signed a convention of accession to the Arbitration Convention on 21 December 1995 (Accession Convention)\textsuperscript{94}, which provided for the application of the Arbitration Convention to the new Member States.\textsuperscript{95}

For the Accession Convention, which like the Arbitration Convention was based on article 293 of the EC treaty, to come into effect a ratification process needed to be completed.\textsuperscript{96}

The Accession Convention entered into force “as between the States which have ratified it, on the first day of the third month following the deposit of the last instrument of ratification by the Republic of Austria or the Republic of Finland or the Kingdom of Sweden and by one State which has ratified the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.” The Accession Convention would then “enter into force for each Contracting State which subsequently ratifies it on the first day of the third month following the deposit of its instrument of ratification.”\textsuperscript{97} For example if Austria ratified the Accession Convention, it would only come into effect between it and all the other states that had ratified the Ac-


\textsuperscript{91} Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, United Kingdom, Spain.

\textsuperscript{92} Art. 18 Arbitration Convention.

\textsuperscript{93} Preamble to the Arbitration Convention.

\textsuperscript{94} Convention on the Accession of the Republic of Austria, the Republic of Finland and the Kingdom of Sweden to the Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises, 89/535/EEC.

\textsuperscript{95} Huibregtse, S.B. & Offermanns, R.H.M.J., What is the future of the EU Arbitration Convention? ITPJ, No. 01, article 3, IBFD 2004, p. 77.

\textsuperscript{96} Ibidem, see also Art. 4 Accession Convention.

\textsuperscript{97} Art. 5 Accession Convention.
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cession Convention when one old and all new Member States had ratified it.98 Thus it required that one old Member state and all new Member States ratified the Accession Convention before the Arbitration Convention could be applied. At the end of 1999 not all new member states had ratified the Accession Convention.99 At the end of 2004 Greece still had not ratified the Accession Convention and thus the Convention was still not applicable between Greece and the three new States.100 Greece only ratified the Accession Convention on 17 January 2005, more than nine years after the agreement on the Accession Convention.101

The European Union expended on 1 May 2004 with ten new Member States and as in 1995, an Accession Convention referring to the Arbitration Convention will need to be ratified by all, now 25, Member States. Although the text of the 2004 Accession Convention has been agreed upon, the ratification by all 25 MS could prove to be very time consuming, considering that it almost took nine years for the ratification of the 1995 Accession Convention.102

The European Commission stated in its communication of 23 April 2004, that the specific problem of the accession of the EU Member States to the Arbitration Convention is of particular concern to the Commission. The time that the 25 EU Member States could take to ratify this instrument might seriously jeopardise its added value for the new EU Member States and for corporate business as a whole in that geographic area.103 Therefore the new Accession Convention states in its article 5 that the Accession Convention applies bilaterally once any two MS have ratified it, thus no requirement that all new and one old MS ratifies it for its applicability.104 Such a provision could have its base in article 24.1 of the Vienna Convention, which states that "A treaty enters into force in such manner and upon such date as it may provide or as the negotiating States may agree."105 The Joint Transfer Pricing Forum has developed a Code of Conduct addressing inter alia the problem of accession. See further Chapter 8.

3.1.2 The life span

The Arbitration Convention came to force on 1 January 1995 for the twelve old MS. The life span of the Convention was initially set at only five years, unless according to its old article 20 it was expressly extended by the Contracting states.

98 IBFD, Status of the EC Arbitration Convention, ITPJ, No. 03, Article 5, IBFD 2002, p. 96.
102 de Hert, A New Impetus for the Arbitration Convention?, p. 54
105 Art. 24(1) Vienna Convention.
However, on 19 May 1998 the EU finance Ministers agreed to extend the Arbitration Convention for an additional 5 years from 1 January 2000 and signed the related Prolongation Protocol on 25 May 1999, which also amended Art. 20 of the Arbitration Convention so that it now provides for an automatic extension of the Convention after every five year period if no objections are raised by the contracting states six months prior to the end of the five year period. This Protocol needed to be ratified by all MS. As no objections were raised by 30 June 2004 the Arbitration Convention is now in force till 2010.

The Prolongation Protocol (Protocol), entered into force on 1 November 2004, three months after all MS had ratified it. Even so the Prolongation Protocol provided in its Art. 3.2 that it took effect from 1 January 2000 and thus provided for a retroactive application of the Arbitration Convention. This meant that any request made under the Arbitration Convention from this date should in principle be valid under the Prolongation Protocol and follow the rules that the Convention provides.

### 3.2 The Prolongation Protocol and the retroactive effect

Due to the lengthy ratification process of the Protocol, the application of the Arbitration Convention for the time between 1 January 2000 and 31 October 2004 is problematic and has lead to debate and differing application. Even though the Protocol states in its Art. 3.2 that the “Protocol shall take effect as from 1 January 2000” and thus provided for a retroactive effect of the Convention, in practice this has not been the simple case. The provisions of the Protocol do not explain further what is meant by its retroactive effect and thus led to differing interpretations by the Member States.

As of 31 December 2004 there were 107 mutual agreement procedure cases pending under the Arbitration Convention. The so-called mutual agreement procedure expressed in Art. 6.1 of the Arbitration Convention states that if an enterprise considers that the transfer pricing principles have been violated, it may, within three years of the first notification of the action that results in double taxation, present its case to the competent authority of its Member State. Articles 6.2 and 7.1 further state that if this complaint is well-founded, the competent authority must endeavour to resolve the case, within two years, by mutual agreement procedure with the competent authority of any other State concerned. The procedures are analysed in chapter 5.

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110 Art. 3(2), Prolongation Protocol.


112 Articles 6(2) and 7(1) of the Arbitration Convention.
In 65 of these 107 cases the time spent on the mutual agreement procedure phase of the convention exceeded 2 years and in 24 cases the request for action under the Arbitration Convention was made prior to 1 January 2000 and were pending for 5 years.\textsuperscript{113}

After the Convention re-entered into force in November 2004 there are three different periods of interest; where a request for action under the Arbitration Convention was made before 1 January 2000, where the request was made between 1 January 2000 and 31 October 2004 and finally where the request was made after 1 November 2004.

\subsection*{3.2.1 Where the request was made before 1 January 2000}

As the Accession Convention had not come into force by the end of 1999, this period can only have contained requests from the original 12 member states.

Where such requests for mutual agreement procedures were made before the expiration of the Arbitration Convention, it remained applicable after its expiration. This in accordance with Art. 18 of the Convention, which states that “The Convention shall apply to proceedings referred to in Article 6.1 which are initiated after its entry into force.”\textsuperscript{114}

Art. 6.1 of the Convention requires only an enterprise to present its case within three years of the first notification of the action that could result in double taxation, to the competent authority of its Member State and inform that competent authority if other contracting states are concerned.\textsuperscript{115} Thus in the author’s opinion, where this was fulfilled the procedures under the Convention were fully applicable even after the Convention’s expiration. This interpretation was also expressed by the Joint Transfer Pricing Forum.\textsuperscript{116}

Thus the 24 cases where a request was made prior to 1 January 2000 should have been subject to the rules of the Arbitration Convention before the re-entry of the Convention on 1 November 2004. However, the arbitration procedure was initiated in only two cases. One of these cases, between Italy and France, was resolved in March 2003.\textsuperscript{117} This case is analysed in chapter 7.

The Joint Transfer Pricing Forum has urged the Member states concerned with the 24 cases to initiate the arbitration procedures.\textsuperscript{118}

\begin{thebibliography}
\item []\textsuperscript{113} EU Joint Transfer Pricing Forum, report on the re-entry into force of the arbitration convention, Brussels, 30 May 2005, p. 2.
\item []\textsuperscript{114} Art. 18 of the Arbitration Convention.
\item []\textsuperscript{115} Art. 6(1) of the Arbitration Convention.
\item []\textsuperscript{116} EU Joint Transfer Pricing Forum, report on the re-entry into force of the arbitration convention, Brussels, 30 May 2005, p. 4.
\item []\textsuperscript{117} EU Joint Transfer Pricing Forum, report on the re-entry into force of the arbitration convention, Brussels, 30 May 2005, p. 4.
\item []\textsuperscript{118} EU Joint Transfer Pricing Forum, report on the re-entry into force of the arbitration convention, Brussels, 30 May 2005, p. 4.
\end{thebibliography}
3.2.2 Where the request was made between 1 January 2000 and 31 October 2004

In this period all new Member States from 1995 and most of the old MS ratified the Accession Convention, thus requests could be made from all MS, except requests for conflicts between the new MS and those old which had not yet ratified the Accession Convention, for instance Greece.

According to Art. 3.2 of the Prolongation Protocol, it took effect from 1 January 2000 once ratified by all MS and thus gave the Arbitration Convention a retroactive applicability for the interim period where the Convention was not in force, 1 January 2000 till 31 October 2004.\(^{119}\) This retroactive effect, which was to ensure an uninterrupted application of the Convention, has been the issue for differing interpretations.\(^ {120}\) According to the Joint Transfer Pricing Forum report of 2004, even though there was a consensus among the MS that the taxpayer’s request to invoke the Convention in principle was valid under the Protocol and thus an enterprise could present its case for the tax authority, in practice the time limits for the mutual agreement procedure and the arbitration phase expressed in the Convention were not applied.\(^ {121}\) There were also differing interpretations whether the mutual agreement procedure should be under the Convention or under the applicable double tax treaty.

The Member states positions mainly were:

1. Regarding the mutual agreement procedure:
   - Germany, Greece, Ireland, Luxembourg, the Netherlands, Spain and the United Kingdom stated that they would accept the mutual agreement procedure under the Convention if the other Member State agreed. If it did not agree, a mutual agreement procedure would be initiated under the applicable double tax treaty if the taxpayer agreed.
   - Austria, Belgium, Denmark, Finland, France, Italy, Portugal and Sweden would accept the request but would continue the proceedings under the relevant double tax treaty. This interpretation was based on the fact that the Arbitration Convention was suspended and only became applicable when it re-entered into force on 1 November 2004. Austria, Denmark and Italy would only continue the procedure under the respective treaty if specifically requested by the taxpayer.\(^ {122}\)

2. Regarding the arbitration procedure:
   - Germany, Greece, Ireland, Luxembourg, the Netherlands, Spain and the United Kingdom would initiate the arbitration procedure under the Convention if the other

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\(^{119}\) EU Joint Transfer Pricing Forum, report on the re-entry into force of the arbitration convention, Brussels, 30 May 2005, p. 2

\(^ {120}\) de Hert, A New Impetus for the Arbitration Convention?, p. 54.


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MS agreed, if it did not agree the arbitration procedure would be replaced with the mutual agreement procedure under the double tax treaty.

- Austria, Belgium, Denmark, Finland, France, Italy, Portugal and Sweden considered the Arbitration Convention suspended and thus would not apply the arbitration procedure either.\(^{123}\)

After the re-entry into force of the Arbitration Convention all Member States except Denmark, Finland, Italy and Sweden agreed that it would be in line with the provisions of the Protocol that the arbitration procedure would be initiated as follows:

- For cases where the mutual agreement procedure was initiated more than two years before 1 November 2004; as soon as possible after the Protocol entered into force, that is as soon as possible after 1 November 2004.
- For cases where the mutual agreement procedure was initiated less than two years before 1 November 2004; two years after the initiation of the mutual agreement procedure.\(^{124}\)

Since Denmark, Finland, Italy and Sweden considered the Convention suspended they applied the rules of the Convention starting 1 November 2004 and thus began with applying the two-year period mutual agreement procedure provided for in Art. 7.1 of the Convention starting on 1 November 2004. Even though Austria, Belgium, France and Portugal also considered the Convention suspended, they would, along with all other MS, except Denmark, Finland, Italy and Sweden, in principle subtract time spent on a mutual agreement procedure under a double tax treaty from the two-year period mutual agreement procedure in Art. 7.1 of the Convention.\(^{125}\) That is if these states’ tax authorities for example had spent 20 months on a mutual agreement procedure according to a double tax treaty, they would in principle only spend an additional 4 months on a mutual agreement procedure under the Convention before invoking the arbitration procedure.

This difference of interpretations is not favourable to secure an equal treatment of taxpayers across the EU. For instance a taxpayer involved in a dispute between two MS, that saw the Convention as applicable and initiated the mutual agreement procedure there under or at least two MS that subtracted the period of mutual agreement under an double tax treaty, could estimate a relief from double taxation being decided at some time in 2005. Whereas a taxpayer involved in a similar case between one or two Member States that did not share any of these views, might have to wait until some time in 2007. The view of the Member States that the time limits under the Convention for mutual agreement procedures did not apply most likely also led to the fact that in reality no cases introduced after 1 January 2000 were submitted to arbitration during the interim period.\(^{126}\)

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\(^{124}\) EU Joint Transfer Pricing Forum, report on the re-entry into force of the arbitration convention, Brussels, 30 May 2005, p. 4.

\(^{125}\) EU Joint Transfer Pricing Forum, report on the re-entry into force of the arbitration convention, Brussels, 30 May 2005, p. 5.

\(^{126}\) de Hert, A New Impetus for the Arbitration Convention?, p. 54.
Even though these differing interpretations of the Protocol result in an legal uncertainty and as explained might also result in unfair treatment of taxpayers in different jurisdictions, there is limited possibility for taxpayers aiming for a fair treatment to bring a legal action against a Member State for incorrect application of the Protocol. As explained, the chosen instrument takes the Arbitration Convention out of the scope of scrutiny of the ECJ and the alternative left is a domestic court. But considering the duration of such procedures it would be easier for the taxpayer to wait for the expiry of the two year mutual agreement procedure starting in November 2004.\textsuperscript{127}

3.2.3 Where the request was made after 1 November 2004

After the interim period, when the Prolongation Protocol had been ratified, the Convention re-entered into effect for the 15 Member states, except between Greece and the Member states that joined the EU in 1995 because Greece had not yet ratified the Accession Convention.\textsuperscript{128}

Thus where a request for action was made after 1 November 2004 the provisions of the Convention were to be followed. As mentioned Art. 3.3 of the Prolongation Protocol provides for a suspension of the 3-year deadline for enterprises to submit requests for action under the Convention during the period of ratification, 1 January 2000 till 1 November 2004.\textsuperscript{129} Thus, considering that by end of 2005 only 13 months had gone by since the re-entry of the deadline, taxpayers may still to date file requests where the first tax assessment notice resulting, or likely to result in, double taxation dates back to 1998. Where a first notice of tax assessment resulting, or likely to result in, double taxation was made after 1 January 2004 the three year application period started on 1 November 2004 and ends 31 October 2007.\textsuperscript{130}

3.3 Legal basis

The Arbitration Convention is based on Art. 293 of the EC Treaty, which states that: “Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals (...) the abolition of double taxation within the community”.\textsuperscript{131}

The intergovernmental form of the Convention and the legal basis in Art. 293 have consequences:

- The Convention does not confer any powers to the ECJ, and the Court subsequently has no jurisdiction under Art. 234 or any powers to interpret or enforce the provisions of the Convention. This also means that the Commission can not initiate any

\textsuperscript{127} Ibidem.


\textsuperscript{129} Art. 3(3) Prolongation Protocol.

\textsuperscript{130} Art. 3(3) Prolongation Protocol.

\textsuperscript{131} Art. 293 EC Treaty.
action under Art. 226 EC against a Member States that fails to comply with the Convention. The national jurisdictions thus are the final judges and interpreters on the application of the Convention, which as has been showed, and will be further showed under chapter 5, can lead to differing interpretations.\textsuperscript{132}

- Unlike a Directive, a multilateral convention under public law does not of itself have direct effect in, and priority over, national law. Such effect and priority will only apply if national constitutional law of the Member States involved recognise self-executing provisions of international law and its priority over national law. Hence the effectiveness of a multilateral convention depends largely on national jurisdictions.

- The Convention does unlike a Directive not feature an implementation deadline. All Member states therefore had to wait for the ratification of the last Member State for the Convention to take effect. This as explained was rather inefficient as it took 5 years for the original member states to ratify the Convention.\textsuperscript{133}

The choice of legal basis was made, as discussed earlier, due to consideration of the Council and the reluctance of the Member States to surrender fiscal sovereignty to the Community. However, the choice of a multilateral convention also has the advantage compared to a Directive that the Directive could, through its implementation in domestic law, result in too many different versions and interpretation divergences.\textsuperscript{134} Another advantage compared to Directives is that amendments made to domestic law through Directives could risk disturbing the carefully balanced system of tax treaties as such treaties, being international agreements, have to be interpreted in accordance with other principles than those governing interpretation of domestic laws that are being approximated by Directives.\textsuperscript{135}

Nevertheless, the choice of legal basis is controversial and has even resulted in the questioning of the validity of the Convention. Originally the Commission in 1976 had proposed a Directive, and had the view that transfer price adjustments and resulting international double taxation directly affect the establishment and functioning of the common market.\textsuperscript{136} National law in this area should therefore be harmonised by Directives under Art. 94 of the EC treaty, which states that: \textit{“The council shall, acting unanimously on a proposal from the Commission (…), issue Directives for the approximation of such laws (…) of the Member States as directly affect the establishment or functioning of the common market.”}\textsuperscript{137}

\textsuperscript{132} Ben Terra \& Peter Wattel, European Tax Law, 3\textsuperscript{rd} edition, Kluwer Law Internaional, 2001, p. 407. Also de Goede, Jan, European Integration and Tax Law, ET, No. 06, Article 4, IBFD 2003, p. 205.

\textsuperscript{133} Ben Terra \& Peter Wattel, European Tax Law, 3\textsuperscript{rd} edition, Kluwer Law Internaional, 2001, p. 407.

\textsuperscript{134} Huibregts, \& J Offermanns., What is the future of the EU Arbitration Convention?, p.78.


\textsuperscript{136} Terra \& Wattel, European Tax Law, p. 406.

\textsuperscript{137} Art. 94 EC Treaty.
In the Commission’s view, Art. 293 is a complementary provision, which is expressed in the article by *so far as necessary*, and should only be used where other legal bases, like Art. 94, do not suffice. This subsidiary character of Art. 293 is, in the author’s opinion, also implied by the context since Art. 293 is found under the rather short, last part of the EC Treaty entitled “general and final provisions”, compared with Art. 94, which is found under part three, entitled “community policies”, chapter three of Title VI, entitled “approximation of laws”. This context implies that Art. 293 was only meant to be a tool for the “leftovers”.

Therefore, the lawful nature of the Convention has been questioned by some commentators. There have been arguments that considering that the Directive proposal in 1976 was not withdrawn, but maintained by the Commission at the time the Arbitration Convention was signed, the action by the Member States violated community law. This is based on that Art. 5 of the EC Treaty requires the institutions of the Community to act within the limits conferred upon them by the Treaty and Art. 94 assigns the Council with the power to approximate national laws which directly affect the establishment and functioning of the common market. The provision in Art. 94 includes abolishing double taxation in the Community. Thus when the Member States entered the Arbitration Convention under Art. 293, they violated the competence of the Council in Art. 94 and also Art. 10 of the EC Treaty which imposes Community loyalty on the Member States. This would mean that if the Commission brought the issue before the ECJ, the court might find that community law was breached and therefore the Arbitration Convention should be terminated.

The commission has chosen not to challenge the validity of the Convention. This most likely due to that if the Convention were to be ruled void, such an act would still not bring about the adaptation of an Arbitration Directive and would thus be counterproductive. Such an act would also be less in line with the EC Treaty objective of abolishing double taxation in the Community, and therefore frustrate the Community more, than the continued application of a Convention that contributes to the abolishment of double taxation.

This view is supported by the fact that on January 17, 1984, Commissioner Tugendhat addressed a Communication to the Council stating that it was “*only the outcome which mattered. It was for this reason and to facilitate a compromise, that (the commission) was prepared to consider solutions, other than the arbitration procedure (Directive) proposed.*”

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139 Articles 5 and 94 of the EC Treaty.


3.3.1 Legal status of the Convention: an international or supranational Convention?

A controversy regarding the Convention is that there are different interpretations as to whether the Convention should be considered an ordinary international treaty, such as bilateral tax treaties, or if it is a supranational act with superior legal value. This raises the question whether the Convention takes precedence over bilateral tax treaties. This is especially relevant since a growing number of tax treaties include clauses for arbitration and also may provide arbitration for a wider range of disputes than the Convention as tax treaties not only apply to transfer pricing.\(^{143}\)

Art. 293 of the EC Treaty imposes on the Member State an obligation to negotiate with each other to secure the abolition of double taxation within the Community. This obligation is largely fulfilled by bilateral tax treaties.\(^{144}\) The Convention, being based on this subsidiary EC Treaty provision, could be deemed to constitute a mere international, multilateral treaty with the same legal status as, for instance, any other bilateral double taxation treaty and thus no status in EC law or supranational character. This interpretation applies the Vienna Convention’s rules for determining the ranking of the Convention and whether to apply the Convention or latter tax treaties, such as the principle of \textit{lex posterior derogat de lege priori} and the international principle \textit{lex specialis derogat de lege generali}.\(^{145}\)

The conclusion that the Convention is simply an international treaty which does not have any status in EC Law can further be based on the need for ratification of the Convention and its prolongation, which ultimately was made automatic through the Prolongation Protocol which also needed ratification, and the fact that new EU Member States are not automatically included in the Convention but they need to sign an accession convention which all Member States then need to ratify. It is also based on the lack of jurisdiction of the ECJ and of reviewing powers of the Commission. Also the fact that the Convention in it’s Art. 15 states that it shall not affect the fulfilment of wider obligations under other conventions or even domestic law of the Member States contributes to the view that the Convention is an ordinary international convention.\(^{146}\)

However, according to an alternative interpretation the Convention and subsequently the arbitration decision thereunder, have EC-wide supranational legal status irrespective of the international agreement form. This view is justified by reference to the legal basis of the Convention.\(^{147}\) The Convention was concluded, as its preamble provides, by the plenipotentiaries of the Member States acting as representatives of governments wishing to give effect to Art. 293 of the EC Treaty to eliminate double taxation within the


\(^{144}\) Hinnekens, Luc, Different Interpretations of the European Tax Arbitration Convention, p. 248.


\(^{147}\) Op. Cit. p. 11.
community. This point is stressed in the preamble, which states that “The high contracting parties to the Treaty Establishing the European Economic Community, desiring to give effect to Art. 220 (now Art. 293) of that Treaty, by virtue of which they have undertaken to enter into negotiations with one another with a view to securing for the benefit of their nationals the elimination of double taxation, considering the importance attached to the elimination of double taxation in connection with the adjustment of profits of associated enterprises, have decided to conclude this Convention, and to this end have designated as their Plenipotentiaries (...)who, meeting within the Council and having exchanged their Full Powers, found in good and due form, have agreed as follows.”

The preamble stresses that the Member States acted in order to fulfil the effect of Art. 293 and the importance of eliminating double taxation in order to fulfil the objectives of the EC Treaty. Thus, based on its legal base and its objective and purpose, the Convention can be deemed to have very close connection to the Community.

In the author’s view a close connection to the Community is also established by the fact that the plenipotentiaries met within the Council to conclude the Convention and the fact that several articles of the Convention that involves the Council. Art. 4 of the Convention states that the Member States shall inform the Council about the independent persons who are nominated to be part of the arbitration procedure, Art. 17 states that the ratification documents of the Convention shall be deposited to the Council and finally Art. 21 states that in order to revise the Convention a conference shall be convened by the Council.

However, the Convention does in fact not form a part of EC law and it does not exist or operate within the institutional framework of the Community, such as the ECJ. Thus the Convention is interpreted to have special supranational legal status higher than that of ordinary international treaty law, being closely related to Community law but not a part thereof. This higher legal status implies that the Convention is not regulated by ordinary principles of the Vienna Convention on the Law of Treaties, but by the principle lex superiori derogat de lege inferiori. In either case the Commission has stated in the EC Commission’s staff working paper on company taxation in the internal market, that the Convention does in fact take precedence over bilateral tax treaties. The precedence can, as seen, be derived from different interpretations.

### 3.3.2 Relation with other legal systems

The Convention has its own framework of provisions but to these apply several other legal systems thus it is not a closed legal act. Some of the legal acts that apply affect the Conventions interpretation of terms, others affect the procedures given within, some

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148 Hinneken, Different Interpretations of the European Tax Arbitration Convention, p. 249.

149 Preamble to Arbitration Convention.

150 Hinneken, Different Interpretations of the European Tax Arbitration Convention, p. 249.


152 Hinneken, Different Interpretations of the European Tax Arbitration Convention, p. 249.

may affect the operation of the Convention more directly than others.\textsuperscript{154} Chapter 5 will reveal how the provisions of the Convention provide for its own legal framework in its scope of application, principles and procedures, but also how there are areas that are left for the interpretation under other legal acts and the interpretation of the Member States.

### 3.3.2.1 Rules of the competent authorities

Art. 11.2 provides that “The competent authorities concerned may agree on additional rules of procedure”\textsuperscript{155} This article allows for the application of agreed upon terms between the competent authorities when setting up the arbitration procedure. Such terms may include the cost of the arbitration procedure, wages to the involved advisory commission members and which competent authority should take the initiative to establish the commission. It can also include where the commission should meet, which language to be used, how the commission’s work should be presented and if, and how, the commission’s resolution should be published.\textsuperscript{156} Many of these areas have been harmonised through the provisions of the Code of Conduct analysed under chapter 8.1.

### 3.3.2.2 Community law

Even though the Convention was signed by the Member States as an act under Art. 293 of the EC Treaty, the Convention is not part of the legal sphere or institutional framework of the EC. Therefore the Convention is not subject to the rules of the EC Treaty for the creation, implementation, legal effect or judicial scrutiny of the Community institutions. Since the Convention is based on Art. 293 of the EC Treaty with a view of securing the objectives in articles 2 and 3, the two legal acts are normally not in conflict. Art. 3.2 expressly states that the interpretation of undefined terms shall have the meaning which it has under the double taxation convention between the States concerned and may therefore not be interpreted with reference to their meaning under community law.\textsuperscript{157}

As the ECJ is not competent to interpret or enforce the provisions of the Convention, there is no uniform legal control and the interpretation of undefined terms and the convention as a whole are mainly left to the national competent authorities and domestic courts. This results in the possibility that the Convention will not be interpreted in a uniform manner.\textsuperscript{158} Furthermore the Commission can not initiate infringement action under Art. 226 of the EC Treaty against any Member State that has failed to follow the Convention or applied its provisions incorrectly.\textsuperscript{159} Although the Convention does not fall within the competence of the ECJ, the Member States could still under Art. 239, which states that “The Court of Justice shall have jurisdiction in any dispute between Member States which relates to the subject matter of this Treaty if the dispute is submitted to it


\textsuperscript{155} Art. 11(2) Arbitration Convention.

\textsuperscript{156} Schelpe, The Arbitration Convention: its Origin, its Opportunities and its Weaknesses, p. 75-76.


\textsuperscript{158} Huibregts, & J Offermanns, What is the future of the EU Arbitration Convention?, p.78.

\textsuperscript{159} Hinnekens, The European Tax Arbitration Convention and its Legal Framework I, p. 146.
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under a special agreement between the parties”\textsuperscript{160}, have entered into an agreement that would extend the competence of the ECJ to the Convention. The lack of ECJ competence is in the author’s view, unfortunate for the application of the Convention. Not only could the ECJ establish definite interpretations of procedures and terms and thus eliminate the different application and interpretation of the Convention, it could also ensure that Member States did not unjustly refuse the application of the Convention. Thereby the Convention’s goals would be better guaranteed.

3.3.2.3 Bilateral double taxation treaties

The Convention in Art. 3.2 directly refers to the Member States’ enacted double taxation treaties for the interpretation of undefined terms unless the context otherwise requires. There is a direct relation between the Convention and the tax treaties as they deal with the same issue of eliminating double taxation in transfer pricing matters. The chosen procedures are also similar in the two systems and there are common principles expressed, such as the arm’s length principle, expressed in articles 9.1 and 7.2 under the OECD Model treaty and Art. 4 of the Convention. Some other provisions of the tax treaties might, however, not be in accordance with the procedures of the Convention. For instance the tax treaty rules for intra-company (branch and head office) income allocation in articles 7.1 – 7.4 of the OECD Model differ from the rules in the Convention which are only expressed by a regulation in its Art. 4 corresponding to Art. 7.2 of the OECD Model. Therefore, a mutual agreement procedure under a tax treaty may well result in different and even more accurate decisions than reached by the arbitration commission under the Convention.\textsuperscript{161}

Another interpretation problem because of the reference to tax treaties for undefined terms may result from first; that not all Member States may have tax treaties with all other Member States, and second; there may be more than two MS involved thus there may be differing meanings of terms under the multiple bilateral tax treaties. Finally not all terms may be defined under the tax treaties either.\textsuperscript{162} The double taxation treaty network between the Members States is not complete and in the potential case of no existing tax treaty it is uncertain whether the undefined terms will be interpreted in line with the OECD Model tax Convention or according to domestic legislation.\textsuperscript{163}

Considering the legal nature of the Convention there is an uncertainty whether the convention prevails over tax treaties as a higher ranking act. As discussed above there are different views of the nature of the Convention. The first view is that the Convention is an ordinary international tax convention and has no status under EC law and therefore no supranational character that prevails over the tax treaties. This idea is as explained based on the fact that Convention and its subsequent protocols needed to be ratified. The other view gives the Convention supranational legal status and it therefore prevails.

\textsuperscript{160} Art. 239 of the EC Treaty.
\textsuperscript{161} Hinnekens, The European Tax Arbitration Convention and its Legal Framework I, p. 150.
\textsuperscript{162} Huibregtse, & J Offermanns, What is the future of the EU Arbitration Convention?, p.78.
over tax treaties. This view is based on Art. 293 of the EC Treaty, which establishes a close connection between the Convention and the European Community.\(^{164}\)

Where the Member States have entered into treaties that result in more far-reaching and effective obligations than those of the Convention, the Convention avoids conflict, no matter if it is considered a supranational or international treaty, by its Art. 15, which states that “Nothing in this convention shall affect the fulfilment of wider obligations with respect to the elimination of double taxation, resulting either from other conventions to which Member States are or will become parties or from the domestic law of the Contracting States”.\(^{165}\) The Convention is silent in regard to conflicts with bilateral treaties that are less-far-reaching. Therefore the difference in interpretation of the legal status could result in differing results. If the Convention is interpreted as an international treaty, the application of international principles and the hierarchical rules of the Vienna Convention, will lead to that a latter or more specific bilateral treaty dealing with the scope of the Convention prevails over the Convention.\(^{166}\) However, if the Convention is interpreted as a supranational treaty, its provision will by the principle lex superior derogat de lege inferiori prevail even if the bilateral treaty is of a latter date and more specific.\(^{167}\)

### 3.3.2.4 OECD Transfer Pricing Guidelines

The Convention does not provide for how an adjustment of enterprise profits shall be made in order to be in accordance with the arm’s length principle, which is expressed in its Art. 4. Nor are any methods for the determination of an arm’s length price stated. The Convention does furthermore not provide what types of transactions would be covered by its Art. 4. Thus, there is an uncertainty how the arbitration commission will decide the correctness of a transfer pricing adjustment, if it may freely do so or if it is bound by certain international principles.\(^{168}\) In international law, as discussed under chapter 2, the arm’s length principle and the procedure for adjustments are addressed under articles 9 and 7 of the OECD Model Convention and further explained in the OECD Guidelines, which can be considered as the most important document on transfer pricing.\(^{169}\) Art. 4 of the Convention is an exact copy of articles 9.1 and 7.2 of the OECD Model Convention, thus there is, in the author’s view, a close link in the interpretation. This relevance of the tax treaty between the two concerned Member States is further shown by the reference in Art. 3.2 of the Convention to the tax treaties for undefined terms. The importance of the Guidelines is also a result from the approval given to it by

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\(^ {164}\) Huibregtse, C. J. Offermanns, What is the future of the EU Arbitration Convention?, p.78.

\(^ {165}\) Art. 15 Arbitration Convention.

\(^ {166}\) Lex posterior derogat de lege priori, Art. 30 of the Vienna Convention.


\(^ {168}\) Adonnino, Pietro, Some Thoughts on the EC Arbitration Convention, European Taxation, No. 11, article 3, IBFD 2003, p. 402.

\(^ {169}\) Ibidem.
the OECD member countries, thus the Guidelines can play an important role at the arbitration commissions deliberations.  

### 3.3.2.5 National law

As explained there are undefined terms and procedures under the Convention for which it, by its Art. 3(2), refers to the definitions under the applicable tax treaty. However, not all terms are defined in tax treaties either and for those terms there is a corresponding reference in Art. 3(2) of the OECD Model Convention, which refers to the laws of the contracting states for definitions. For instance the term *enterprise* is defined neither in the Convention or the OECD Model Convention. Thus there is an indirect reference from the Convention to *lex fori* for defining terms and procedures not defined under the Convention. These procedures will be further examined under chapter 5. In the situation where there is no tax treaty it is unclear whether the undefined terms will be interpreted according to national law or in line with the OECD Model Convention. This since the Convention does not refer to domestic legislation in itself; the reference is made through tax treaties that have a provision similar to 3(2) of the OECD Model Convention. The application and administration of the Convention can thus be affected by the national laws and placed under the scrutiny of national institutions. This dependence on national law does not offer the same guarantee of uniform and autonomous interpretation and application as if the Convention would have been subject to the scrutiny of the ECJ.

### 3.4 Conclusions

The choice to conclude the arbitration system under a convention instead of a Directive has, as was shown in this chapter, led to a number of factors and some disadvantages. The choice left it for the member states to adopt the Convention without any deadline as for a Directive. This was rather inefficient as it took 5 years for the original member states to ratify the Convention. Then in 2000 it took nearly 5 years for the Member States to ratify the Prolongation Protocol and the Accession Convention. As there were different interpretations of applicability during the interim years, enterprises and business were not guaranteed any sure form of application.

The interpretation of the retroactive effect of the Protocol, as has been shown, mainly divided into two different views among the Member States. One interpretation saw the Convention as suspended during the interim years whereas the other interpretation saw the procedures as applicable but in practice did not follow the time limits under the Convention. The basis for the differing interpretations will be analysed in chapter 9.

The problem remains after the interim period that some member states will start the mutual agreement procedure as of the date the Convention was applicable whereas the others will subtract time spent on a mutual agreement procedure under the bilateral tax treaty from the two year limited mutual agreement procedure under the Convention. One aspect of the retroactive effect is also that enterprises, due to the suspension of the

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170 Hinnekens, Different Interpretations of the European Tax Arbitration Convention, p. 251.


three year deadline, will still today be able to request for action for cases of double taxation from 1998.

The issues regarding the Protocol and the accession of new member states would have been avoided had the provisions of the Convention been realised through a Directive. Enterprises would thus in that sense have benefited from a Directive. As the Arbitration Convention is in principle not subject to the scrutiny of the ECJ, domestic appeal seems the only possible route to challenge an allegedly incorrect implementation of the Arbitration Convention. Also, if an enterprise feels that the differing interpretation of the Protocol and its retroactive effect leads to unjust differing treatment of taxpayers within the Community, the only possible way to challenge the interpretation would be through a domestic court, a process that might take more than the two additional years of mutual agreement procedure an enterprise would have to wait for the arbitration procedure.

Today the Convention has, in the author’s opinion, shed many of these childhood problems. The convention is automatically extended thus no need for lengthy ratification, the accession has been made more efficient and, as will be explained, through the work of the Joint Transfer Pricing Forum the application of the Convention has also been made easier.

Yet another controversy is that the Convention leaves terms and procedures undefined. It is not defined how to determine an arm’s length transaction or a corresponding adjustment. This lack of definitions leave the arbitration commission with the choice of using either any method they deem fit or applying international provisions such as the OECD Guidelines. In the author’s opinion it is most likely that the arbitration commission would apply the OECD Guidelines since Art. 3.2 of the Convention directly refers to the applicable double taxation treaty for undefined terms. As the Convention does not extensively explain the arm’s length principle or how to establish a price at arm’s length and given that a majority of the Member States applying the Convention have treaties modelled after the OECD Model Convention, to which the OECD Guidelines apply, the Guidelines may be important for the decision making of the arbitration commission. Furthermore, national law may also be applicable for undefined terms as the tax treaties themselves refer to domestic legislation for undefined terms. These conclusions will be important for the analysis of whether the Convention could apply to double taxation resulting from thin capitalisation.

The legal basis and form of the Convention has resulted in a controversy in the interpretation of whether the Convention is an international convention or if it should enjoy an elevated status as supranational quasi-community act. There are proponents of both interpretations. Nevertheless, the Convention, could in the author’s opinion be deemed to constitute a minimum standard, based on its Art. 15. This will be analysed in chapter 9. The discussion is of interest if Member States enter into latter, or latter and more far reaching obligations to abolish double taxation under double taxation conventions. If a latter treaty is adopted and the Convention is viewed as an international treaty, with the same status as double taxation treaties, the Vienna convention’s principle *lex posterior derogat de lege priori* could imply that the latter treaty is to be followed.

The interpretation of the Convention as a quasi-community law enjoying a higher legal status than international agreements is based on the fact that the legal basis for establishing the Convention was Art. 293 of the EC Treaty and thus established a close connection between the EC treaty and the Convention. This as the article left to the Member
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states the responsibility to negotiate collectively an agreement in order to achieve the objectives of the EC Treaty. This interpretation can also be furthered, in the author’s view, by the fact that Convention was an answer to a community move, the proposed Directive, which failed. The Directive was not accepted, even if it was due to the member states hesitation to surrender fiscal sovereignty. Therefore, Art. 293 as a subsidiary article to 94 was chosen, both by the Council and the Member States to be used for the area that could not be resolved through Art. 94. This as a move under community law, involving the Commission and the Council establishes a relation between the Community’s institutions and the Convention.
4 The Scope of the Arbitration Convention

"This Convention shall apply where, for the purposes of taxation, profits which are included in the profits of an enterprise of a Contracting State are also included or are also likely to be included in the profits of an enterprise of another Contracting State 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."  

This chapter will present the scope of the Convention; to which issues it applies. This is important in order to gain an understanding of the scope of the Convention and what criteria are set up for the application of the Convention. This is imperative for the analysis of the third question of the thesis; whether the Convention can apply to double taxation arising from thin capitalisation cases, which will be analysed in chapter 9.

4.1 Territorial scope

The Convention’s territorial scope is the European Community, which is expressed in Art. 16 (1) referring to Art. 299 (1) of the EC Treaty (old 227). It excludes, however, territories referred to in 299 §§ 2,3 and 4 of the EC Treaty and in its own Art. 16 (2), such as French overseas departments, the Faroe Islands, Greenland, etc. Naturally the Convention requires ratification by the Member States before it becomes applicable within this territorial scope, as explained in Chapter 3.1.1.

4.2 Taxes covered

According to Art. 2 of the Convention, it applies to taxes on income and a list of existing income taxes in the Member States follow in Art. 2.2. This list is specific but should not be deemed as restrictive as it states that the Convention should apply to “in particular the following”. It covers income taxes on physical persons, companies, residents, non-residents, principal taxes and surtaxes. Thus the Convention does not exclude enterprises because of legal form, it applies to individual persons, partnerships and companies as long as they are enterprises. The Convention further states in Art. 2(3) that it shall apply to future identical or similar taxes. It does not cover stamp duties, taxes imposed on a taxpayer’s wealth and other non-profit based taxes.

One issue is that the Convention, unlike the OECD Model Convention in its Art. 2, does not refer to income taxes imposed on behalf of a Member State’s political subdivisions or local authorities, furthermore these taxes are, in Art. 2.2 of the Convention, listed for...

173 Art. 1 Arbitration Convention.
174 Art. 16 Arbitration Convention.
175 Art. 2(1) Arbitration Convention.
some of the Member States but not for others. Although this is rather ambiguous, one should bare in mind the general term delimiting the scope of application of the Convention; *taxes on income*, the fact that the list is not meant to be restrictive and the basic purpose of the Convention. This, in the author’s opinion, justifies the application of the Convention also to those kinds of local taxes.

As penalties are often calculated as a percentage of the adjusted amounts they economically make up a part of the adjustment. The penalties do not, however, constitute income taxes or adjusted amounts included in both enterprises’ taxable profits and thus the Convention does not apply to such penalties.¹⁷⁹

### 4.3 Scope of application

The preamble to the Convention sets out its purposes, stating that the Convention has been concluded by the Member States “…with a view to securing for the benefit of their nationals the elimination of double taxation, considering the importance attached to the elimination of double taxation in connection with the adjustment of profits of associated enterprises…”¹⁸⁰ Art. 1(1) establishes the scope of the Convention, stating that “where, for the purposes of taxation, profits which are included in the profits of an enterprise of a Contracting State are also included or are also likely to be included in the profits of an enterprise of another Contracting State on the grounds that the principles set out in Article 4 (...) have not been observed.”

The Convention does not require that the adjustment of profits results in higher taxation or double taxation, the simple fact that there has been an adjustment made to the profits of an enterprise is thus sufficient. The Convention does further for its applicability not require that the adjustment amounts result in actual profits, that is, it will apply even where the enterprise has carry-over losses that are greater than the profits attributed to the enterprise. This is expressed in Art. 1(3): “Paragraph 1 shall also apply where any of the enterprises concerned have made losses rather than profits.” This expresses the intention of the Convention to eliminate double taxation in all cases of adjustment of profits, irrespective if both enterprises have carry-over losses and therefore the effective double taxation will only arise in the future.¹⁸¹

The Convention is not applicable to cases which simply relate to transfer pricing but do not concern double taxation due to profit adjustments. The Convention furthermore does not apply to cases in which double taxation arises from differing interpretations regarding permanent establishments and likewise excludes cases of double taxation where there are disputes regarding the interpretation of the Convention’s terms. Disputes regarding the meaning of “profits”, “associated”, “residence” or the taxes and matters covered by the Convention and other terms determining the scope of the Convention are not arbitrable under the Convention. Where such disputes can not be solved under the


¹⁸⁰ Preamble to Arbitration Convention.

mutual agreement procedure under the applicable double taxation treaty they can only be referred to national courts.\textsuperscript{182}

4.3.1 Enterprise of a Contracting State

The Convention according to its Art. 1 applies to situations where profits which are included in the profits of an enterprise of a Contracting State are also included or are also likely to be included in the profits of an enterprise of an other Contracting State.\textsuperscript{183}

The terms \textit{enterprise of a contracting state} and \textit{enterprise} are not defined in the convention. Through Art. 3(2) the Convention refers to the applicable tax treaty. The definitions under Art. 3 in the OECD Model Convention are, respectively, \textit{“an enterprise carried on by a resident of a Contracting State”} and \textit{“the carrying on of any business”}. The term \textit{business} is defined as \textit{“the performance of professional services and of other activities of an independent character”}.\textsuperscript{184} There are also terms that lack definition under the Model Convention. For undefined terms, for instance \textit{profits}, the Model Convention refers to domestic law.\textsuperscript{185}

The Convention is also silent regarding the connecting factor between an enterprise and the Member State concerned. Through its Art. 3(2) it refers to the applicable tax treaty and thus the criterion of residence in Art. 4 under the OECD Model Convention. The Model Convention states that a \textit{“resident of a Contracting State means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature”}.\textsuperscript{186} In case of dual residency according to the domestic laws, the tie breaker rules in Art. 4(2), (3) of the OECD Model Convention will apply where the applicable tax treaty is modelled on the Model Convention.

The problem with undefined terms, which are also not defined under a tax treaty, being referred to domestic law is that there might be an incongruity between domestic terms.\textsuperscript{187} Such incongruity might lead to the inapplicability of the Convention as the Convention procedures do not apply to cases of double taxation caused by differences of interpretation of its terms. For instance, a tax authority of one state might question the finding of residency by another tax authority and thus rule out arbitration on the grounds that the profits are not attributable to that other authority.\textsuperscript{188} All such issues of applicability of the Convention fall within the jurisdiction of the domestic courts to

\begin{thebibliography}{99}
\bibitem{183} Art. 1 Arbitration Convention.
\bibitem{184} Art. 3(1) OECD Model Convention.
\bibitem{185} Art. 3(2) OECD Model Convention.
\bibitem{186} Art. 4 OECD Model Convention.
\end{thebibliography}
which a taxpayer may refer his case, as they are neither arbitrable under the Convention or interpretable by the ECJ.  

4.3.2 Associated Enterprises and Permanent Establishments

The enterprises involved must be associated and the nature of the association is defined in Art. 4(1) of the Convention. The article refers to direct or indirect participation in management, control or capital by one enterprise in the other or by the same persons. It also defines the arm’s length principle for intra-group transfer pricing of groups of enterprises and of parent and subsidiary companies, companies under common control and permanent establishments.  

Art. 4(1) is a word by word copy of Art. 9(1) in the OECD Model Convention and Art. 4(2) is a word by word copy of Art. 7(2) of the OECD Model Convention. Although the generality of the wording in these articles were purposefully so designed, to give them a broad meaning, they too bring the issue of differing interpretations and thus the inapplicability of the Convention. The lack of definition of the term associated is, for instance, problematic as some Member States require a fixed level of the direct and indirect holding of share capital and/or voting rights. Generally Member States have a threshold of 25%, but in some Member States it is higher for instance 51%. Yet other Member States take into account the facts and circumstances of each case. Since the wording of these articles are the same in both the Convention and the OECD Model Convention, there is considerable weight attached to the OECD Commentary regarding the interpretation of Art. 9 and by the same token the interpretation of Art. 4 of the Convention.  

The criteria of association involves two or more distinct enterprises but the required link is also satisfied in the relationship between an enterprise and its permanent establishment which, through the separate entity approach of the arm’s length principle, is considered to be a separate entity. This is expressed in the Convention’s Art. 1(2); “For the purposes of this Convention, the permanent establishment of an enterprise of a Contracting State situated in another Contracting State shall be deemed to be an enterprise of the State in which it is situated.” Thus the Convention is applicable to cases of economical double taxation which, for instance, arise when one Member State adjusts up the profits of a subsidiary and subsequently taxes these profits, while the same profits are included in the taxable base of the parent company and taxed by a second Member State, as explained in Chapter 2.5.1. The Convention is applicable also to cases of juridical double taxation, which for instance arise where the profits generated by a branch in one Member State form part of the profits of the enterprise located in an other Member State to which the branch be-


190 Art. 4 Arbitration Convention.


194 Art. 1(2) Arbitration Convention.
longs and are taxed in both Member States, as explained in Chapter 2.5.2. Although these entities form one subject the Convention as explained considers them to be separate entities.

It is not expressed how the Convention applies in triangular cases or cases where there are more than two enterprises involved. The text of the Convention and the principles in its Art. 4, suggests that each pair of associated enterprise will be dealt with as a separate case. This can be interpreted by the wording of Art. 4(1) which states that “where an enterprise of a Contracting State participates in (…) an enterprise of another Contracting State (…) and conditions are imposed between the two enterprises in their commercial or financial relations”. Thus the Convention would be applied bilaterally between the multiple Member States where an MNG may operate. However, the procedure could alternatively for complex cases be conducted as a single multilateral procedure with the participation of all the involved tax authorities. This would be beneficial for complex cases involving multiple enterprises as separate procedures may risk resulting in inconsistent or incoherent decisions. This interpretation for a single multilateral procedure is based on the provision in Art. 6(1) of the Convention stating that “if other Contracting States may be concerned in the case (…) the competent authority shall notify the competent authorities of those other Contracting States.”

4.3.3 Serious penalty - Exclusion from the scope

The Convention does not apply to all cases of double taxation resulting from profit adjustments. Art. 8(1) of the Convention states that the competent authority of a state shall not be obliged to follow the procedures under the Convention where legal or administrative proceedings have resulted in a final ruling that due to the actions, giving rise to the adjustment of transfers of profits, one of the enterprises concerned is liable to a serious penalty.

Art. 8(2) states that where such judicial or administrative procedures are conducted simultaneously with the procedures under the Convention, the competent authorities may stay the procedures under the Convention until the judicial or administrative procedures are concluded. Thus the Convention aims to exclude from its application deceitful transfer pricing practices that aim for tax manipulation and tax evasion.

The serious penalty clause refers to the domestic law of each Member State for the definition of what constitutes a serious penalty in that Member State. These definitions were added as Individual Declarations to the Convention. The Declarations show that the Member States have differing definitions regarding what constitutes unacceptable transfer pricing with a serious penalty as result. Some Member States include only cases where there is dolus, other include also cases of culpa. Greece and some other Mem-

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195 Art. 4(1) Arbitration Convention.
198 Art. 8(1) Arbitration Convention.
199 Art. 8(2) Arbitration Convention.
ber States for instance find it sufficient that an undertaking fails to submit declarations or submits incorrect declarations, whereas in Spain administrative penalties for serious tax infringements and criminal penalties for offences committed with respect to the tax authorities constitute serious penalties. Luxembourg’s definition is more puzzling and elusive as it considers serious penalties to be what the other Contracting States consider as serious penalties. These differing interpretations of the term serious penalty might result in differing application and although a company that follows the tax laws and provisions in the jurisdictions it is active should generally not be concerned, divergence of the interpretation adds to an uncertainty of the applicability of the Convention and also leads to unequal treatment of enterprises.

Furthermore, the penalty clause is problematic as penalties should not be related to the possibility of having double taxation abolished, as this will have the effect that double taxation is used as a penalty. Non-compliance with transfer pricing regulations should not be punished by penalties disguised as double taxation.

4.4 Conclusions

The Arbitration Convention has as purpose to eliminate double taxation in connection with the adjustment of profits of associated enterprises; this is expressed in the Convention’s Preamble. The Scope of the Convention is elimination of double taxation where, for the purposes of taxation, profits which are included in the profits of an enterprise of a Contracting State are also included in the profits of an enterprise of another Contracting State on the grounds that the principles set out in Art. 4 have not been observed.

Art. 4 refers to direct or indirect participation in management, control or capital by one enterprise in the other or by the same persons. It has been shown here that the Convention has a number of undefined terms that are referred to the applicable tax treaty, and also national legislation for definitions. This is an unfortunate solution since there might be differing interpretations regarding key terms, such as associated, enterprise and profits, which, as has been shown, can lead to the inapplicability of the Convention as it does not apply to cases of dispute over the definition of its terms. This is unfortunate since the double taxation of associated enterprises might be resulting from such a difference of interpretation in the first place.

The penalty exclusion excludes from the scope of the Convention such cases of double taxation where the enterprise, according to domestic legislation, has committed deceitful transfer pricing practices. What Member States consider to be unacceptable or deceitful is differing and thus the penalty exclusion has a differing effect in the Member States. This is yet another case where there is differing interpretations regarding when the Convention should apply.

Since Art. 4 is a word by word copy of articles 9(1) and 7(2) of the OECD Model Convention it can be concluded that there is a definite relation in the interpretation of these articles. Considerable weight thus attaches to the OECD Commentary as regards the interpretation of articles 9 and 7 of the bilateral treaties, and thus also to the interpretation

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201 Individual Declarations of the Contracting States on Art. 8, Arbitration Convention.

of Art. 4 of the Convention. The fact that the Model Convention also refers to domestic law for undefined terms will also have a bearing on the scope of the Convention.

The conclusions made in here, based on the examined purpose and scope of the Convention, are the basis for the analysis in chapter 9.3 of the applicability of the Convention to thin capitalisation.
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5 Procedure for Resolution of Double Taxation

The issue of double taxation poses a serious obstacle to the internal market and double taxation resulting from transfer pricing rules is part of that obstacle. There is a great importance of having appropriate mechanisms for eliminating such double taxation as quickly, efficiently, in as many cases as possible and for the lowest possible costs for business and tax authorities. This is shown not only by the large amount of intra-company and inter-company trade but also by that about 60% of multinational enterprises’ tax managers identify transfer pricing as their main tax problem.203

There are generally today four existing mechanisms for avoiding or settling transfer pricing double taxation:

• Litigation at national courts,
• mutual agreement procedures under the double taxation treaties,
• the procedures under the Arbitration Convention and
• advance pricing agreements.204

In this chapter the procedures under the Convention will be analysed for the fourth question of the paper; to analyse the efficiency of the Convention’s procedure, and thus its efficiency in resolving double taxation resulting from transfer pricing, compared to other existing measures. The three other measures are examined in Chapter 6 for this end. The Chapter will explain how the measures under the Convention, three phases, are designed to function and analyse problems because of the wording of the Convention and lacking definitions. This is also done to further show that there may be differing interpretations that would benefit from the overview of a single supranational organisation. The Chapter will not examine problems with the Convention’s practical application, this is done under chapter 7.

As has been shown, the aim of the Convention is to eliminate economical and juridical, international double taxation arising when a Member State adjusts upward the profits or taxable income of an enterprise due to transactions which are not at arm’s length and when an other Member State does not allow a corresponding downward adjustment of the profits or taxable income of the associated enterprise, established in that Member State, which benefited from the transactions that were not at arm’s length. The Convention provides for a resolution where an adjustment of profits will or is likely to result in international double taxation.205

203 Terra & Wattel, European Tax Law, p. 403.
5.1 The procedure under the Arbitration Convention

The procedure for eliminating double taxation under the Convention consists of three stages. First, the enterprise that is subject to an adjustment may submit a claim under the Convention for a resolution of double taxation to the competent authority of the Member State it has its residence in. Such claim shall be submitted within three years of the first notification of the action that results or is likely to result, in double taxation. Subsequently that competent authority shall notify the other Member States where the associated enterprise participating in the transfer pricing arrangement is established.\(^{206}\) Second, if the claim appears to be well-founded, and if the competent authority is not by itself able to arrive at a satisfactory solution, the competent authority shall endeavour to resolve the case through a mutual agreement procedure with any other competent authority concerned, with a view to the elimination of double taxation.\(^{207}\) This where the enterprise has not been found liable to serious penalty because of the transaction that is not in accordance with transfer pricing provisions. Finally, if the concerned authorities cannot agree on a resolution for the elimination of the international double taxation within two years, an advisory commission shall be set up to deliver an opinion for resolution of the double taxation.\(^{208}\) The advisory commission has six months from the date on which the matter was referred to it to deliver an opinion.\(^{209}\) Once the opinion has been delivered the competent authorities have an additional six months to take a decision to eliminate the double taxation. Their decision may deviate from the advisory commission’s opinion, however, if they have not come to an agreement within the six months they are

\(^{206}\) Art. 6(1) Arbitration Convention.

\(^{207}\) Art. 6(2) Arbitration Convention.

\(^{208}\) Art. 7(1) Arbitration Convention.

\(^{209}\) Art. 11(1) Arbitration Convention.
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obliged to act in accordance with the opinion of the advisory commission.\(^{210}\)

5.1.1 The notification and unilateral relief procedure

Art. 5 of the Convention states that where a Contracting State intends to adjust the profits of an enterprise, it shall inform that enterprise of the intended action in due time and give it the opportunity to inform the other enterprise concerned, so as to give that other enterprise the opportunity to inform the other Contracting State. The first mentioned Contracting state is however not prevented from making the adjustment even where such opportunities have not been given.\(^{211}\) It may even happen that the first mentioned Contracting State, in accordance with domestic deadlines, proceeds with the tax assessment before notifying the enterprise of its intention to adjust. Such non-compliance with the provision for notification would have no consequence as the enterprise preserves its right to present its case for resolution under the Convention.\(^{212}\) Technically, in the author’s opinion, it would only result in that the three year deadline starts to run later, when notification is finally actually given.

The article further states that if, after such information has been given by the first mentioned Contracting State, the two enterprises and the other Contracting State agree to the adjustment and thus there is a corresponding adjustment made by the other Contracting State and the Convention does not further apply.\(^{213}\) The Convention does not impose any principles to be followed for the adjustment or corresponding adjustment to be valid, only the requirement that both enterprises and the other Contracting State agrees to the adjustment. There are also no expressed time limits for the other contracting states agreement. By the agreement of the other Contracting State is also meant that it makes a corresponding adjustment. The provision for the mandatory notification is based on the practical consideration of avoiding the unnecessary application of international procedures where if both enterprises and the other Contracting State agrees to the adjustment.\(^{214}\)

5.1.2 The mutual agreement procedure

This stage of the procedure under the Convention is regulated under its Art. 6.

"Where an enterprise considers that, in any case to which this Convention applies, the principles set out in Article 4 have not been observed, it may, irrespective of the remedies provided by the domestic law of the Contracting States concerned, present its case to the competent authority of the Contracting State of which it is an enterprise or in which its permanent establishment is situated. The case must be presented within three years of the first notification of the action which results or is likely to result in double

\(^{210}\) Art. 12(1) Arbitration Convention.

\(^{211}\) Art. 5 Arbitration Convention.

\(^{212}\) Hinnekens, Different Interpretations of the European Tax Arbitration Convention, p. 253.

\(^{213}\) Art. 5 Arbitration Convention.

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taxation (...). The enterprise shall at the same time notify the competent authority if other Contracting States may be concerned in the case. The competent authority shall then without delay notify the competent authorities of those other Contracting States.”

5.1.2.1 The presentation of a case

Where an enterprise considers that the transfer pricing principles, set out in Art. 4, have been violated, it may present its case to its competent authority. This wording implies that it is the taxpayer, the associated enterprises, that have the initiative for the submission of a case under the Convention and not the involved authorities. The affected enterprise presents its case to the competent authority of the Contracting State of which it is an enterprise or in which its permanent establishment is situated.

In what form the enterprise should present its claim and what documents and arguments to include is not regulated in the Convention. Such form could be given by provisions under the Member States domestic laws. The form used for filing a domestic tax complaint could apply for instance. The Dutch and UK form for instance calls for the names and addresses of the enterprises involved, the identification of the involved tax authorities, a description of the facts and circumstances of the case and the object of the application. Such object of application has been recommended to involve a clarification that the mutual agreement procedure under the Convention and not the applicable tax treaty is invoked. The application should in either case involve the reasons for the complaint which should be based on the objection that the transfer pricing principles in Art. 4 have not been observed. This since Art. 6(1) states that where an enterprise considers that the principles set out in Art. 4 have not been observed, it may present its case to the competent authority. The Joint Transfer Pricing Forum has stated that for a case to have been presented or submitted, and to enable the competent authority to assess whether a complaint is well founded, a minimum of information from the taxpayer is necessary. The work of the JTPF is further examined in chapter 8.

The affected enterprise shall also, according to Art. 6(1), at the same time inform its authority if other Contracting States may be concerned in the case. This wording implies that the presentation of the enterprise’s claim should also include a notification of other states that are involved. Some commentators argue that the language of the article would not allow a subsequent notification to this end. In the author’s opinion, it is however unlikely that a subsequent notification of involved Contracting States would not be accepted given that the deadline for submitting a claim is three years long. The competent authority shall then without delay notify the competent authorities of those other Contracting States.

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215 Art. 6(1) Arbitration Convention.
216 Art. 6(1) Arbitration Convention.
219 Art. 6(1) Arbitration Convention.
other states.\textsuperscript{222} This provision is, in the author’s view, also rudimentary as it does not express a specific time limit and thus leaves it for interpretation.

As explained the complaint must be presented within three years of the first notification of the action that results or is likely to result, in double taxation.\textsuperscript{223} There are differing interpretations to the notion \textit{first notification of the action} and it could for instance be interpreted as a request for additional information from the taxpayer in a case, a communication to the taxpayer of the tax authority’s intent to make an adjustment which could result in double taxation, a sending to the taxpayer of the tax audit report or sending the taxpayer a tax re-assessment notice.\textsuperscript{224}

The criterion, likely to result, is in the author’s opinion meant to allow an enterprise to make claims where the other Contracting State has been notified in accordance with Art. 5, as explained in 5.1.1. above, but the Contracting State has not yet given notice of whether it agrees to the adjustment and thus will make a corresponding adjustment eliminating the double taxation, or that it disagrees with the adjustment.

The criteria is however, in the author’s opinion ambiguous as it would seem that a suspicion of double taxation could fall under it and thus it would raise a question of what level of certainty regarding a double taxation is required to file a claim, this is however in the author’s view not its purpose. This also since the audit itself of the enterprise’s transfer pricing practices and relating inquires, is insufficient to make a claim as long as the intended adjustment is not properly identified and notified.\textsuperscript{225}

\textbf{5.1.2.2 The procedure}

The Convention does not provide for any procedural rules for the mutual agreement procedure. The procedure is essentially diplomatic between the competent authorities, which will themselves determine how the procedure will be conducted. Parties to the procedure are the competent authorities and the enterprise has no legal standing in the procedure. According to Art. 6(2) if the complaint appears to be well founded, and there is no serious penalty exclusion as explained in chapter 4.3.3, the competent authorities “shall endeavour to resolve the case (…) with a view to the elimination of double taxation (…)” and shall according to Art. 7(1) “within two years of the date on which the case was first submitted to one of the competent authorities in accordance with Article 6(1)” have reached an agreement.\textsuperscript{226} The tax authority to which the case was presented only has to initiate the mutual agreement procedure “if it is not itself able to arrive at a

\textsuperscript{222} Art. 6(1) Arbitration Convention.

\textsuperscript{223} Art. 6(1) Arbitration Convention.


\textsuperscript{226} Articles 6(2) and 7(1) Arbitration Convention.
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*satisfactory solution*. By *satisfactory* should be meant a result that is acceptable to both enterprises and the other tax authority.

The two year time limit is a great improvement of the mutual agreement procedure compared to the one under bilateral tax treaties, where there are no time limits and the procedures have in practice even lasted for ten years. Even though the two year limit may be prolonged, such prolongation may only be made through mutual agreement and only with the consent of the associated enterprises. However, there have been concerns that such time limit could have a negative result in that the tax authorities will not endeavour to make a complete and active analyse of the case since they know that if they do not reach an agreement the case will be referred to the advisory commission. Such conduct could result in that the six months of arbitration would be too short for completing a decision where there are not enough findings necessary for a decision according to the principles of Art. 4. The author believes however, as Hinnekens has argued, that the time limit will act as an incentive for the tax authorities to become more eager to solve an issue since, given competent authorities’ reluctance to give up taxation powers, also displayed during the creation of the Convention explained in chapter 3, where they do not reach an agreement by their own, the tax matter will be taken out of their hands.

The start of the two year time limit also poses an interpretation problem as the Convention does not provide in its articles 6(1) or 7(1) for any requirements except for the *submission to one of the competent authorities in accordance with Article 6(1)*, or the *presentation*, of the case to start the two year mutual agreement period. What constitutes a case as *submitted* or *presented* is not defined. This was explained for *present* above in chapter 5.1.2.1. The Member States interpretations of when the two year limit starts to run thus may differ. For instance according to a Commission Services transfer pricing questionnaire distributed in mid 2000 one Member State took the position that the two-year period does not start until the other State has formally notified that it does not accept the adjustment. According to five other Member States, the two-year period starts when the tax authorities receive a request from the taxpayer. Two of these Member States also expressed that a request cannot be made until the tax authorities have actually made the adjustment, as no double taxation will occur until this point. Another Member State took the position that the two year period does not start until all necessary information has been provided to the tax authorities.

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227 Art. 6(2) Arbitration Convention.

228 *Hinnekens*, Different Interpretations of the European Tax Arbitration Convention, p. 255.


230 Art. 7(4) Arbitration Convention.


232 *Ibidem*.


The mutual agreement reached shall according to Art. 6(2) be implemented irrespective of any time limits prescribed by the domestic laws of the Contracting States concerned. A Contracting state may therefore not refuse an implementation of an agreement resolving the double taxation on grounds of domestic time limit regulations.

5.1.2.3 The relation to domestic remedies

The enterprise can refer the case to the procedures under the Convention irrespective of domestic remedies provided for.\textsuperscript{235} The two do not exclude each other and they do not even compete at the stage of the mutual agreement procedure, which is only binding for the competent authorities and not for the domestic courts the enterprise could submit its case to. This parallel existence theoretically gives the enterprise an option of choosing one of the remedies or both.\textsuperscript{236}

However, where the case has so been submitted to a court of a tribunal, the two year limit for the mutual agreement procedure is computed from the date on which the judgement of the final court of appeal is given.\textsuperscript{237} This provision can in many cases require the taxpayer to choose between domestic courts and the mutual agreement procedure under the Convention as a combination of both would lead to a too long delay in obtaining a binding decision under the Convention. The total procedure could equal to the duration of the national judicial proceedings up to the final court of appeal, which could be rather lengthy, plus the two years of international mutual agreement, if the double taxation was not resolved by the domestic judicial remedy, and the additional six months of arbitration and six months of decision making, where the mutual agreement did not solve the double taxation. Thus the independence of the two remedies could in reality be very limited and enterprises may be discouraged to apply for both remedies.\textsuperscript{238}

5.1.3 The advisory commission procedure

The mutual agreement procedure is, short of the time limit, basically the same procedure that is found under the OECD Model Convention, the innovative feature of the Convention therefore mainly lies in the system for mandatory and multilateral arbitration regulated in its articles 7 – 11.

If the competent authorities concerned fail to reach an agreement that eliminates the double taxation within two years of the date on which the case was first submitted to one of the competent authorities, they shall set up an advisory commission charged with delivering its opinion on the elimination of the double taxation in question.\textsuperscript{239} There is one exception to this obligation and that is when the enterprise has resorted to domestic judicial remedies as well as the Convention for solving the double taxation and the domestic laws of a Contracting State do not permit the competent authorities of that State to derogate from decisions of their judicial bodies. In such case the competent authori-

\textsuperscript{235} Art. 6(1) Arbitration Convention.

\textsuperscript{236} Hinnekens, The European Tax Arbitration Convention and its Legal Framework II, p. 299.

\textsuperscript{237} Art. 7(1) Arbitration Convention.

\textsuperscript{238} Com (2004) 297 final, p. 23.

\textsuperscript{239} Art. 7(1) Arbitration Convention.
ties are only required to set up an advisory commission if the time provided for an appeal has expired or if the enterprise has withdrawn such an appeal before a decision was given.\textsuperscript{240} This often results in the withdrawal of their domestic judicial remedies by taxpayers.\textsuperscript{241}

The advisory commission can request information, documents and evidence to be provided by the competent authorities as well as the enterprises and each enterprise may even ask to appear or be represented before the advisory commission.\textsuperscript{242}

The opinion of the advisory commission must be delivered within six months from the date the matter was referred to it.\textsuperscript{243} The competent authorities shall then within six months of the date on which the advisory commission delivered its opinion take a decision which will eliminate the double taxation. The competent authorities may take a decision which deviates from the advisory commission's opinion but if they fail to reach agreement within the six months, they shall be obliged to act in accordance with the advisory commission’s opinion.\textsuperscript{244}

The advisory commission is to consist of, in addition to a Chairman, two, or one if so agreed, representatives of each concerned competent authority and an even number of competent and independent persons which are appointed by mutual agreement, or by drawing of lots, from a list of persons. Alternates for each of the independent persons are appointed in the same way. The list shall consist of all the independent persons nominated by the Contracting States. Each Contracting State shall nominate five persons and shall inform the Secretary-General of the Council of the European Communities thereof. The persons must be nationals of a Contracting State and resident within the territory to which the Convention applies. The representatives and the independent persons then elect a Chairman, which must possess qualifications for appointment to the highest judicial offices in his country or be a jurisconsult of recognised competence, from the same list. The Contracting States shall take all necessary steps to ensure that the advisory commission meets without delay once cases are referred to it.\textsuperscript{245}

There are holes in the Convention regarding the procedures of the advisory commission, such holes are provisions for which competent authority that shall take the initiative to establish the advisory commission, where the advisory commission is to meet, who will support the costs of the procedure, when a case is considered as being referred to the advisory commission, what the level of fees of the Members and Chairman are, what will be the content of the opinion and what are the conditions for its publication and which language will be used.\textsuperscript{246} However, it is stated that the Contracting States will

\textsuperscript{240} Art. 7(3) Arbitration Convention.

\textsuperscript{241} Rousselle, The EC Arbitration Convention – An overview of the Current Position, p. 16.

\textsuperscript{242} Art. 10(1) Arbitration Convention.

\textsuperscript{243} Art. 11(1) Arbitration Convention.

\textsuperscript{244} Art. 12(1) Arbitration Convention.

\textsuperscript{245} Art. 9 Arbitration Convention.

\textsuperscript{246} Com(2004) 297 Final, p. 23.
share the advisory commission’s procedural costs.\textsuperscript{247} As explained under chapter 3.3.2.1 the competent authorities involved may agree on rules to cover these questions. Some of them are also dealt with by the JTPF further examined in chapter 8. However, the lack of precise and detailed provisions has in practice led to problems as will be shown under chapter 7.

One more area left to be decided by the competent authorities and the consent of the concerned enterprises, is the publishing of the advisory commission’s opinion.\textsuperscript{248} The fact that advisory commissions’ opinions might not become published and that each advisory commission that is set up will have a different composition may very well result in differing treatments of similar cases and an uncertainty for business as to what to expect.\textsuperscript{249} Even if double taxation is eliminated an enterprise may have preferences as to how profits are allocated. As will furthermore be shown under 5.1.3.1, what considerations an advisory commission has to take into account when deciding a case, are only very generally stated in the Convention.

Another area of uncertainty is when the six month period for the advisory commission starts to run. The Convention states only that “if the competent authorities fail to reach an agreement (…) within two years of the date on which the case was first submitted (…), they shall set up an advisory commission charged with delivering its opinion on the elimination of the double taxation in question” and that “the advisory commission (…) shall deliver its opinion not more than six months from the date on which the matter was referred to it”.\textsuperscript{250} It is, according to the author’s interpretation, apparent that the second provision refers to the moment where a case is referred to the advisory commission, whereas the first only states that the advisory commission shall be set up after the two year mutual agreement procedure has ended. The question becomes whether a case can be referred to the advisory commission before it has been set up. There are differing views on this issue. One view is that the starting point is expressed under the first provision in Art. 7(1), and the six months start to run at the end date of the two year mutual agreement procedure, leaving it up to the involved Member States to get the advisory commission phase started as quickly as possible. Another view is that a case can only be referred to the advisory commission after such a commission actually has been established and that therefore the six month deadline starts to run once the advisory commission has been set up and the case has been referred to it.\textsuperscript{251} This interpretation leads to more controversy as the obvious question becomes how long time can be spent on setting up an advisory commission. This problem has led to practical issues as will be examined in chapter 7.

A substantial number of Member States have requested that they would like the problems with the time limits to be clarified.\textsuperscript{252}

\textsuperscript{247} Art. 11(3) Arbitration Convention.

\textsuperscript{248} Art. 12(2) Arbitration Convention.


\textsuperscript{250} Art. 7(1) and 11(1) Arbitration Convention.


5.1.3.1 The legal basis of the advisory commission’s opinion

As mentioned the provisions for the advisory commission’s opinion are rather rudimentary. The Convention provides a legal basis for the advisory commission’s opinion in Art. 11(1) which simply states that “the advisory commission must base its opinion on article 4”\textsuperscript{253} Art. 4, as is explained under 4.3.2, is an expression of the arm’s length principle. The Convention does not contain or refer to any more rules to apply for the criteria to be followed by the advisory commission’s opinion.

This may result in problems in relation to the advisory commission’s methods for judging double taxation cases and how it should solve double taxation. One problem could be whether an adjustment, from which the double taxation derives, is based on the correct application of transfer pricing principles, what the justifications are for the adjustment and how suggested solutions should allocate taxation rights.\textsuperscript{254}

As was mentioned under 2.4.2 there are various methods for determining an arm’s length price, and different Member States may apply different ones resulting in differing arm’s length transfer prices. The advisory commission may apply their own choice of method that could lead to yet another result and different advisory commissions may choose different methods, which further reduces the predictability of the outcome of the procedure. Furthermore, as explained in 4.3.2, there are a number of undefined terms under Art. 4 that may be interpreted differently by different advisory commissions, which will further the inconsistency in advisory commissions’ opinions.

The commission does not look at the legitimacy of the adjustment, but rather on its results and justifications for it. An adjustment must reflect the reasoning that was used for the assessment of the applied prices.\textsuperscript{255}

5.1.3.2 Taxpayers’ rights

The procedure, being international, is conducted between the Contracting States and their competent authorities. It deals with the taxation conflict between the Contracting States in accordance with the Convention that they have agreed to.\textsuperscript{256} It is thus the competent authorities, party to the procedure, that take a decision to eliminate the double taxation as the only parties to the procedure.\textsuperscript{257} Although the competent authorities are the only parties to the procedure, it does not mean that the taxpayer is not involved and rather as an interested third party the taxpayer is not indifferent to how the double taxation is eliminated. There is a difference for MNG where the profits are being allocated, given differences in tax burden or the profit/loss situations of the enterprises. This

\textsuperscript{253} Art. 11(1) Arbitration Convention.

\textsuperscript{254} Adonnino, Some Thoughts on the EC Arbitration Convention, p. 405.

\textsuperscript{255} Ibidem.


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means that the enterprises have an interest in having the compatibility of their transfer pricing with the arm’s length principle verified by correct criteria. 258

Therefore the taxpayer is under the arbitration procedure given the opportunity for participation unlike under the mutual agreement procedure where he has no legal position. Under the mutual agreement procedure the taxpayer instead, as explained, maintains his right to access domestic judiciary regardless of the outcome of the mutual agreement.

The Convention provides in its Art. 10(1) that “the associated enterprises concerned may provide any information, evidence or documents which seem to them likely to be of use to the advisory commission in reaching a decision. The enterprises and the competent authorities of the Contracting States concerned shall give effect to any request made by the advisory commission to provide information, evidence or documents.” 259 It is further provided that “each of the associated enterprises may, at its request, appear or be represented before the advisory commission. If the advisory commission so requests, each of the associated enterprises shall appear or be represented before it.” 260

In this right to appear should also be implied the right to hear, improve and refute presentations, arguments and evidence of the competent authorities, this also in accordance with the international principle of fair hearing. 261

According to 10(1) the competent authorities have no obligation to provide information if they are not obtainable under domestic law or administrative practice or if such information would disclose business secrets. Although this could, through e contrario interpretation, result in that the enterprises would not have this right, the right to refusing to disclose certain information should also be applicable to the enterprises, since their right to eliminate double taxation should not be lost because of fear of having to disclose business secrets. 262 Also given that the right for competent authorities to refuse to provide certain information is to protect the taxpayer, it would, in the author’s view, be contrary to the purpose of the provision if the enterprise would not have the same right.

5.2 Conclusions

The Convention provides for a guaranteed resolution of the double taxation. It obliges the tax authorities to reach an agreement if they do not wish to have to implement the opinion of the advisory commission. However, the Convention does leave a number of issues unregulated and open for interpretation in under its procedures as well. These areas may very well prolong the period in which the competent authorities should have reached an agreement. This will be shown in practice in chapter 7. The start of the three year period deadline is not clear as there may be differences in interpretation of what a notification resulting in, or likely to result in, double taxation constitutes in reality. Also what constitutes a case as being presented, setting of the two year deadline for the mu-

258 Adonnino, Some Thoughts on the EC Arbitration Convention, p. 404.

259 Art. 10(1) Arbitration Convention

260 Art. 10(2) Arbitration Convention


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tual agreement procedure is left to the discretion of the tax authorities. Furthermore, the time limits and practical procedures under the arbitration procedure under the Convention are vague and left to great influence by interpretations. For these reasons one of the advantages with the Convention, the elimination of double taxation within a time limit, is greatly diminished.

Another problematic area is the taxpayers’ right to access domestic remedies as well as the Convention. During the mutual agreement procedure the taxpayer theoretically retains this right, and in a way security, if he is not satisfied with the resolution, although in reality there might be problems as has been shown. The question is whether the taxpayer would have any such security after the arbitration procedure of the Convention. This question will be analysed in chapter 9.
6 Other Mechanisms to Resolve Double Taxation

In this chapter the other mechanisms available for resolving double taxation, as mentioned in the preceding chapter, will be presented in order to be able to analyse the Conventions benefits or disadvantages compared to them in chapter 9.

6.1 Domestic courts

Transfer pricing cases are not considered to be suitable for litigation in domestic courts. This is because transfer pricing mainly has its focus on economics and is not a juridical discipline and therefore cases become very fact specific with considerable amounts of material to be reviewed, which leads to transfer pricing litigation being very lengthy. Litigation at domestic courts is also one-sided in that it only deals with the problem from the perspective of one of the jurisdictions and therefore may not take into account differing views on establishing arm’s length prices. Litigation therefore does not guarantee elimination of double taxation. Furthermore, where double taxation is not relieved in the national courts the possibility to do so in a subsequent mutual agreement procedure under a tax treaty is also reduced.  

This, in the author’s opinion, partly since substantial time might have gone by and the other Member State may no longer have necessary documentation for such resolution but partly also since the court’s judgement might make the tax authority more reluctant to compromise in a situation where it has been given right by its jurisdiction. Furthermore, expenses for preparing and litigating transfer pricing cases is often very high for both the enterprises and tax administrations, making it unlikely that litigation would be applied as a general double taxation avoidance mechanism.

In the author’s opinion, subjecting a transfer pricing issue to a domestic court, where the profits of the enterprise have been adjusted, is not, in the direct sense, a remedy for avoiding double taxation, it is rather a means for questioning the adjustment made by the tax authority. The parties to the litigation are not the two contracting states that imposed the double taxation; it is the taxpayer and the tax authority that made the profit adjustment resulting in double taxation. Thus the domestic court is not technically to assess whether there is a double taxation and to resolve it, since it can not relieve it anyway, but is rather to assess whether the adjustment by the tax authority itself satisfies the arm’s length principle.

As has been shown such assessment is dependent on interpretation with different methods, which can result in differing outcomes. For instance even where an enterprise has applied transfer pricing practices that are accepted in one Member State, the same practice might not be accepted by another Member State and this difference may lead to differing transfer prices. Therefore, the assessment whether or not to eliminate the adjustment, which must in its entirety be eliminated for a complete avoidance of double taxation, is a different issue than realising that a MNG is subject to double taxation that should be relieved. Where resolved by a mutual agreement procedure both competent authorities can present and analyse the differing views with the aim of securing such a


264 Ibidem.
resolution. Furthermore, there is the possibility that a court will rule in favour of the tax authority, which would leave the enterprise with the problem of double taxation and furthermore also with the expenses for the litigation, perhaps even the winning parties expenses, which could be rather costly for a lengthy litigation. Naturally there is a risk that the double taxation is not relieved under a mutual agreement procedure as well, but there at least there are no additional expenses for the enterprise.

### 6.2 Mutual agreement procedure under the OECD Model Convention

The mutual agreement procedure is a well established means for tax administrations to solve disputes. This procedure, which in bilateral tax conventions modelled after the OECD Model Convention, has its basis in their Art. 25, can be used to resolve double taxation arising from transfer pricing adjustments.  

This is expressly stated in the OECD Commentary on Art. 25 which states that “Article 25 also provides machinery to enable competent authorities to consult with each other with a view to resolving, in the context of transfer pricing problems, not only problems of juridical double taxation but also those of economic double taxation, and especially those resulting from the inclusion of profits of associated enterprises under paragraph 1 of Article 9; the corresponding adjustment to be made in pursuance of paragraph 2 of the same Article thus fall within the scope of the mutual agreement procedure, both as concerns assessing whether they are well-founded and for determining their amount.”  

Transfer pricing issues are just one of three areas where the mutual agreement procedure is generally used. The first area includes cases of “taxation not in accordance with the provisions of the Convention”  

The mutual agreement procedure in this area is typically initiated by the taxpayer and includes the transfer pricing cases. The two other areas include questions regarding interpretation or application of the tax convention and elimination of double taxation in cases otherwise not provided for by the tax convention. These areas do not necessarily involve the taxpayer. The scope of the mutual agreement procedure under the OECD Model Convention is thus wider than the scope of the Arbitration Convention.

As explained in chapter 2.5.1, requests for corresponding adjustments, provided for in Art. 9(2) of the Model Convention may be considered by tax administrations in order to eliminate double taxation. As explained this is not an obligation and where the tax authority of the second state does not agree with the other state’s adjustment there is no obligation to make a corresponding adjustment. Art. 9(2) expressly states that the competent authorities shall if necessary consult each other for the determination of such a corresponding adjustment. Thus, the mutual agreement procedure in Art. 25 may be

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265 OECD Guidelines, Chapter IV, section C, para. 4.29.
266 OECD Commentary on Art, 25, section II para. 9.
267 OECD Model Convention, Art. 25(1), (2).
268 OECD Guidelines, Chapter IV, section C, paragraph 4.30.
used for the consideration of corresponding adjustments. Furthermore, where a tax convention does not include Art. 9(2) the mutual agreement procedure will provide for a possible mechanism to resolve the double taxation, however not all OECD Member States agree to the mutual agreement’s applicability to transfer pricing cases where their tax treaties do not include the second paragraph of Art. 9, or a similar provision.\textsuperscript{269}

Art. 25(1) sets out a three year limit for the taxpayer to present his case to the competent authority. The starting point for the three year limit is the "first notification of the action resulting in taxation not in accordance with the provisions of the Convention".\textsuperscript{270} This provision should according to the Commentary on Art. 25 be interpreted in the way most favourable to the taxpayer. That is even if the tax is charged immediately after an administrative decision, the time limit may only start to run after a notification has been given about the action, that is the time limit starts after what is interpreted most favourable to the taxpayer; the act of taxation itself as evidenced by a notice of assessment or the official demand or other instrument for levy of tax. If the tax is levied by deduction at the source, the time limit is calculated from the moment the income is paid, however if the taxpayer proves that only at a later date did he know that the deduction had been made, the time limit starts from that later date. If the double taxation results from the combined decisions of Contracting States, the time limit will start on the date of the first notification of the most recent decision.\textsuperscript{271}

The mutual agreement procedure consists of two distinct stages. In the first stage, which is started by the taxpayer’s presentation of his objection, the procedure takes place between the taxpayer and the competent authorities to which he has presented his objection. The taxpayer may present his case regardless if he has exhausted all remedies available under domestic law. However, in some Member States competent authorities are bound by court decisions and if a case is pending at a national court, the implementation of a mutual agreement will often be made subject to the taxpayer’s withdrawal of his lawsuit.\textsuperscript{272}

If the competent authority recognises that the complaint is justified and considers that the taxation objected to, is due to a measure taken in that state, the competent authority must satisfy the complaint as speedily as possible by making adjustments or allowing relief. Through this the double taxation can be solved without resorting to mutual agreement procedure. If however it appears to the competent authority that the taxation objected to is due to a measure taken in the other state it will have a duty to set in motion the mutual agreement procedure.\textsuperscript{273}

The second stage is started by the competent authority, to which the case was initially presented, approaching the competent authority in the other state. The procedure is henceforward between the states.\textsuperscript{274} The mutual agreement procedure does not oblige

\textsuperscript{269} OECD Model Convention, Art. 25(2),(3) and OECD Guidelines, Chapter IV, section C, paragraph 4.33.

\textsuperscript{270} OECD Model Convention, Art. 25(1)

\textsuperscript{271} OECD Commentary on Art. 25, section II paragraph 18.


\textsuperscript{273} OECD Commentary on Art. 25, section II, paras. 20-23.

\textsuperscript{274} OECD Commentary on Art. 25, section II, paras. 25.
the competent authorities to reach an agreement and solve the double taxation issue, it merely obliges them to *endeavour* to reach an agreement. The competent authorities may therefore be unable to come to an agreement due to conflicting domestic laws or due to restrictions on the competent authorities’ power to compromise.\textsuperscript{275} The mutual agreement procedure does therefore in no way guarantee that the double taxation will be resolved.

### 6.2.1 Deficiencies with the mutual agreement procedure

There have been expressed concerns about the efficiency of the mutual agreement procedure:

- Time limits under domestic law may make corresponding adjustments unavailable if those limits are not waived in the applicable tax treaty.
- The mutual agreement procedure does not set out any time limits and thus the procedure may take too long time to complete.
- The participation of the taxpayer may be limited.
- Published procedures may not be easily available to guide taxpayers on the procedure.
- There may be no procedures to suspend collection of tax or the accrual of interest while the resolution of the mutual agreement procedure is pending.\textsuperscript{276}
- Taxpayers have also expressed concerns that because transfer pricing cases are so complex, the procedure might not have sufficient safeguards against double taxation.\textsuperscript{277}
- A main disadvantage is of course that the mutual agreement procedure does not oblige the contracting states to reach any agreement, it only requires the competent authorities to endeavour to reach an agreement, and therefore they do not have to achieve any actual result. Thus it does not guarantee a resolution of double taxation.\textsuperscript{278}
- Business has reported that firms do not generally refer cases to the mutual agreement procedure as they consider that the procedure takes too long time and that it takes up too much resources in relation to the exposure.\textsuperscript{279}

\textsuperscript{275} OECD Commentary on Art. 25, section II, paras. 26-27 and OECD Guidelines, Chapter IV, section C, para. 4.31.

\textsuperscript{276} OECD Guidelines, Chapter IV, section C, para. 4.42.

\textsuperscript{277} OECD Guidelines, Chapter IV, section C, para. 4.40.

\textsuperscript{278} OECD Commentary on Art. 25, section IV, para. 45. and Sinx, Rudolf & ten Broeke, Transfer Pricing Litigation: a Comparison, ITPJ, No. 01, Article 6, IBFD 2002. p. 32.

The Commentaries on Art. 25 admit that the procedure is not entirely satisfactory for the taxpayer, although it expresses that Art. 25 has generally represented the maximum that contracting states were prepared to accept. The main reason for that the article is not satisfactory is, as has been explained, that it does not oblige the Contracting States to actually reach an agreement, they are only required to endeavour to do so. The conclusion of a mutual agreement procedure also depends largely on the competent authorities’ power to compromise under domestic law. Therefore if a tax convention is interpreted or applied differently in two contracting states, and if the competent authorities are unable to agree on a solution within the framework of the mutual agreement procedure, double taxation may not be resolved. The Commentary expressly states that a solution for cases where the two contracting states can not agree would be to seek an advisory opinion from an impartial third party, still leaving the final decision with the states. Another stated solution would be arbitration and the Commentary expressly gives the Arbitration Convention as an example.

### 6.3 Advance pricing arrangement

Advance pricing arrangements (APA) are initiated by the taxpayer and involve negotiations between one or more associated enterprises and one or more tax authorities for the determination in advance of transactions of the criteria, for instance method, comparables, adjustments and critical assumptions to future events, for determining the transfer pricing of the transactions over a fixed period of time. They form a means for the taxpayer to request a binding transfer pricing ruling from the tax authorities on the treatment of a future transaction. These arrangements may cover all the enterprise’s transfer pricing issues or be limited to some specific affiliates or transactions. The arrangement thus is to supplement other mechanisms for resolving transfer pricing issues by avoiding later adjustments and subsequent double taxation.

The reliability of an APA will depend on both the predicted transfer price and the assumptions and criteria on which it was based. A key issue is also for what period of time the APA can specifically prescribe a transfer price for a taxpayer, whether for instance only transfer pricing methodology or more specific results, which then would rely on future predictions, can be involved. The tax administration may use profit ratios of independent enterprises as comparables for determining a APA, but such ratios are also often volatile and hard to predict. Use of profit ranges and historical data for an industry can also be of guidance. Therefore the reliability of a prediction in a APA, and thus the reliability of the APA, depends on the facts and circumstances of each actual case.

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280 OECD Commentary on Art. 25, section IV, para. 45.
281 OECD Commentary on Art. 25, section IV, paras. 46, 48.
282 OECD Guidelines, Chapter IV, section F, para. 4.124.
284 OECD Guidelines, Chapter IV, section F, para. 4.137.
285 OECD Guidelines, Chapter IV, section F, paras. 4.125-4.128.
Some states apply unilateral APAs in which the tax authority and the taxpayer in that state are the only ones involved. These arrangements may be inefficient as tax authorities of other states where associated enterprises are located may not agree to the APA in regard to transactions concluded with the enterprise located in its jurisdiction. The unilateral APA may therefore not lead to an increased level of certainty for the enterprises and a reduction of double taxation for the MNE. Due to concerns of double taxation, most states prefer bilateral or multilateral APAs. These arrangements are more likely to reduce the risk of double taxation as they are equitable to all tax authorities and taxpayers involved.

The APA is a mechanism provided for by domestic legislation and bilateral agreements and the application and procedures as well as the interest to provide a legislative framework for the APA may therefore vary from country to country. APAs are generally not very developed in the EU and only a few Member States have established formal APA programmes. APAs may however in most Member States to some extent be obtained under the scope of domestic ruling procedure provisions and the mutual agreement procedure of double taxation conventions. The OECD Guidelines provides for common Guidelines for operating APAs under the mutual agreement procedure. The eligibility for unilateral APAs will be determined by the domestic requirements of the relevant tax authority whereas the bilateral and multilateral APAs require the reference to tax treaties for legal basis and are governed by the mutual agreement procedure of the applicable tax treaty. In some countries where bilateral APAs have been sought and the tax treaty is not applicable the competent authorities may nevertheless conclude an arrangement in accordance with their executive power.

The APA requires the co-operation of the associated enterprises and they will normally be expected to provide the tax authorities with the transfer pricing methodology considered by them most reasonable under the circumstances and documentation supporting their methodology. This documentation would include, for instance, data relating to the industry, markets and countries to be covered by the APA, it may also identify comparable, independent businesses. The associated enterprises are typically also allowed to participate in the process of obtaining an APA, by presenting the case and negotiating with the tax authorities concerned, providing information and reaching an agreement on the transfer pricing case. This ability for the taxpayer to participate is an advantage over the mutual agreement procedure provided for in the OECD Model Convention.

The APA provides the associated enterprises with a confirmation by the tax authorities that no transfer pricing adjustment will be made as long as the enterprises follow the ar-

286 OECD Guidelines, Chapter IV, section F, paras 4.130, 4.148.
287 OECD Guidelines, Chapter IV, section F, paras 4.131, 4.132.
290 OECD Guidelines, Chapter VIII, Annex III, Section A, para. 7 and Section B, para. 13.
291 OECD Guidelines, Chapter IV, section F, para. 4.134.
292 OECD Guidelines, Chapter IV, section F, para. 4.135.
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rangement. The APA should also include a possibility for its cancellation or revision for future years when business operations change or when economic circumstances critically affect the reliability of the transfer pricing methodology in a manner that would be significant for independent enterprises’ transfer pricing. 293

6.3.1 Advantages of advance pricing arrangements

The APA’s advantage over other mechanisms to solve transfer pricing related double taxation is that it provides a certainty for the taxpayer of how transfer pricing issues are going to be treated before the transactions take place and for a specific period of time. They provide a means for the associated enterprises and the tax authorities to consult and cooperate in a non-conflict and preventative setting. This will also ease the flow of information thus aiding a more accurate and objective review.

The APA may thus prevent time-consuming and costly examinations and litigation for transfer pricing issues. The APA may also reduce the resources needed for subsequent examination of the taxpayer’s return since the tax authorities will already possess information about the taxpayer. The arrangement may in the same way also reduce the time needed under a mutual agreement procedure. 294

The bilateral and multilateral APAs may ultimately substantially reduce the possibility for double taxation since all the concerned parties participate and give their opinion and agreement. 295

6.3.2 Disadvantages of advance pricing arrangements

There are disadvantages with the APA as well. The APA, as explained may be concluded for a longer period of time and there is a risk for unreliable predictions of arm’s length transfer pricing where such predictions are made in changing market conditions for longer periods. The APA may also pose a strain on the tax authorities’ auditing resources as the APA is initiated by the enterprise and the programme as a whole is generally led by the demands form the enterprises seeking a fast conclusion within the frame of their business objectives and time scales. The enterprises’ demands may not coincide with the tax authorities’ budgets and may pose a difficulty for the tax authorities’ to process both requests for APAs and other work. 296 This is a disadvantage compared to the other means of avoiding transfer pricing double taxation discussed where, in the author’s view, the tax authorities make the triggering adjustment and will know that there may be potential subsequent procedures for resolving an arising double taxation and thus may be prepared for the amount of work they potentially will have to deal with. Whereas technically any enterprise with international intra- and inter-group transactions may request for an APA.

293 OECD Guidelines, Chapter IV, section F, para. 4.136.
294 OECD Guidelines, Chapter IV, section F, para. 4.143-4.145.
295 OECD Guidelines, Chapter IV, section F, para. 4.146.
296 OECD Guidelines, Chapter IV, section F, para. 4.150-4.151.
This also poses a concern that very large enterprises, which through experience have been shown most interested in APAs and whose transfer pricing methodology would be examined anyway, would be prioritised over smaller, less compliant enterprises where the APA programmes resources could do more good for reducing the risk of losing tax revenues.\textsuperscript{297} The smaller companies may not have as worked through transfer pricing methods as a larger enterprise will generally have and larger enterprises’ auditing is generally examined to a greater extent. Another disadvantage for smaller enterprises is that the APA can be expensive and time consuming and these enterprises may therefore not be able to afford them.

The practical application of an APA may, for instance for these reasons, be difficult. For the taxpayer one main concern is the complex, costly and time consuming procedures, where the enterprise may be required to prepare higher levels of documentation, for instance the details of predictions and the basis for these, than would otherwise be required. The added amount of work may for the tax authorities also pose a problem as described. For these reasons APAs are primarily used by large enterprises for complex transfer pricing issues involving for instance intangibles and cost-sharing and often involving non- Member States.\textsuperscript{298}

\textbf{6.4 Conclusions}

Domestic courts have been expressed as unsuitable for resolving transfer pricing related double taxation. This due to that the cases often are complex, take much time and are costly for both the taxpayer and the tax authorities. The litigation is also one sided and will mainly test the adequacy of an adjustment where the cases is submitted in the adjusting tax authority’s jurisdiction. Where the courts do not find that the adjustment is improper and should in its entirety be removed, the double taxation will still in part or in its entirety remain without any international incentive for the other involved state to make a corresponding adjustment. Thus the enterprise may have spent time and resources only to arrive back at the start and having to confer its case to another mechanism, if such is still available under the applicable time limits.

The cost is also a great issue with the advance pricing arrangements and as has been expressed may generally only be attractive for large enterprises in complex cases. Although the APA does pose the advantage of dealing with transfer pricing issues preventatively and for a period of time where the involved enterprises may feel secure and avoid conflicts as long as they follow the APA. As has been shown the APA however greatly depends on accurate predictions about markets and economy, which may make it less reliable for longer periods.

There is also the issue that tax authorities could be overwhelmed by requests for these arrangements as they may not have the resources to handle them in an efficient way and within the frame of the enterprises’ business objectives and time scales. The tax authorities would basically also need to have resources to monitor the continuing applicability of an arrangement where such has been concluded for a longer period. The lack of uniform precise, international provisions for how to conduct an APA, with time limits and

\textsuperscript{297} OECD Guidelines, Chapter IV, section F, para. 4.153.

procedures, leaves the APA in the author’s view, open to differing interpretation and application and not a widely applied mechanism.

Since the bilateral and multilateral APAs are referred to the mutual agreement procedure under the tax treaty for conclusion, they may also adopt one of the major disadvantages of Art. 25 of the OECD Model Convention where the tax treaty is modelled after it, namely that there is no obligation to reach an agreement.

The mutual agreement procedure is a well established mechanism for resolving double taxation and also provides for a wider scope of application than the procedure under the Arbitration Convention. There are, however, expressed insufficiencies with the mutual agreement procedure as it does not provide for any time limits for the conclusion of the procedure, nor does it oblige the Member States to reach an agreement and thus where the tax authorities can not agree on a solution within the framework of the mutual agreement procedure, double taxation may not be resolved. The resolution also depends on the competent authorities’ power to compromise under domestic law. These shortcomings are also admitted under the Commentaries on Art. 25.
7 The Arbitration Convention in Practice

This Chapter will examine how the Convention has functioned in practice and how the shortcomings in its provisions for the procedures have affected its efficiency. For this the only dispute, to date, ever to be resolved using both the mutual agreement procedure and arbitration phase of the Convention will be examined. The dispute involved taxation of Electrolux distributor affiliates in France and Italy. As has been explained under chapter 5.1.3, a case under the Convention may be published only if the competent authorities so agree and only with the consent of the taxpayer. Unfortunately there have been practically no official publications regarding this case except for the minutes from the discussions at the JTPF meetings about the case. These discussions, however, form a vital insight to the efficiency and concerns of the Convention as expressed by representatives from the involved Member States. They are for the purpose of this chapter and the fourth question of the thesis; the application of the Convention and concerns thereto, in reality, of much greater interest than the actual opinion of the advisory commission.

7.1 The application of the Convention during the “Electrolux case”

A. The mutual agreement procedure, applicability during the interim period and initiation of the arbitration phase

The mutual agreement procedure phase of the Convention was initiated in 1997, thus during the first five year period that the Convention applied, and some of the tax disputes which had led the MNE to invoke the Convention where resolved under the procedure. However, not all issues were resolved during the two year limited mutual agreement procedure and therefore the arbitration phase had to be invoked. The two states continued to apply the Convention during the interim period for a case where the request had been made before 1 January 2000 as the Convention provides for, explained in chapter 3.2.1. However, it was not until in 2000 that the French competent authority approached the Italian one in order to initiate the arbitration phase. There was then a preparatory meeting held in March 2001.299

B. The unregulated practical questions of the arbitration procedure

As shown under chapter 5.1.3 there are numerous areas of the practical application of the Convention that are left unregulated, these areas the two competent authorities had to agree upon. The French and Italian competent authorities therefore decided, inter alia, that the Contracting State that had made the transfer pricing adjustment should be the one to arrange for the meetings of the advisory commission and that these should all take place in that state. They also agreed that the proceedings under the advisory commission should be held in the language of that state with a subsequent translation into the other state’s language. All costs for the advisory commission; fees and administrative expenses for the independent persons, travel, translation etc, were to be shared equally by the involved Contracting States.300

299 Draft summary record of the third meeting of the EU Joint Transfer Pricing Forum held in Brussels on 2nd April 2003, section IV, Paragraph 12.

C. The setting up of the advisory commission

It proved difficult to find a chairman for the advisory commission, the time needed for studying the documents and for the advisory commission meetings was seen as one reason for why some independent persons turned down requests to take the place as chairman. The list of the independent persons, explained in chapter 5.1.3, was also incomplete and not up to date, which further delayed the establishment of the advisory commission.\textsuperscript{301}

In the end it took one and a half year just to set up the advisory commission, a panel that according to the Convention should have a decision in six months.\textsuperscript{302} However, as has been explained under chapter 5.1.3, the Convention does not expressively state when the 6 month time limit for the advisory commission starts and can therefore be interpreted to leave a “hole” between the mutual agreement procedure and the advisory commission procedure. This is, in the author’s view, one more reason for why it took one and a half years for the Italian and French tax authorities to set up the advisory commission.

The competent authorities also appointed a secretariat of the advisory commission, who was for independence and confidentiality reasons only responsible to the chairman, although the Convention itself does not contain any provisions for the setting up, or even existence, of a secretariat.\textsuperscript{303}

D. The information provided to the advisory commission

The competent authorities agreed that all correspondence between them concerning the case should be available to the advisory commission. The amount and suitability of these documents depended greatly on how well the competent authorities had communicated with each other during the notification and mutual agreement procedures.\textsuperscript{304} This shows, in the author’s opinion, the importance of that the tax authorities endeavour to make a complete and active analysis of the case and are not put off by the fact that if they do not reach an agreement the advisory commission will have a final say anyway. Such conduct, as is implied here, could result in that the six months of arbitration would be inadequate for reaching a decision as explained under 5.1.2.2.

The competent authorities found it helpful to ask the chairman for what documents he considered necessary and he requested for instance the enterprise’s position on the adjustment, why it agreed or disagreed with the adjustment. The advisory commission also wanted to know if the competent authorities had initiated mutual agreement procedures on the case with competent authorities of other Member States and if so whether they had reached any agreement. This raised yet another question under the procedure;

\textsuperscript{301}Op. cit., para. 15.

\textsuperscript{302}Ibidem.

\textsuperscript{303}Op. cit., para. 16.

\textsuperscript{304}Op. cit., para. 17.
whether the advisory commission should have access to correspondence with other competent authorities.\textsuperscript{305}

**E. The date on which the case was “referred” to the advisory commission, starting the six month deadline**

The first meeting of the advisory commission took place in November 2002, more or less five years after the initiation of the mutual agreement procedure and more or less three years after the time limit for the mutual agreement procedure had expired.\textsuperscript{306}

The date on which the case was referred to the advisory commission and the six month deadline for the arbitration procedure, expressed in Art. 11(1) of the Convention, started to run, was interpreted to be the date on which the commission was set up, that is on the date when the first meeting took place. This as it was considered to be very time consuming for the competent authorities to produce all the documents that the chairman considered necessary and for the advisory commission to study these documents.\textsuperscript{307} In the author’s opinion, the deadline could not have been interpreted differently in this case. Had the deadline been interpreted in accordance with the alternative interpretation that the six month deadline starts to run at the end date of the two year mutual agreement procedure, expressed in chapter 5.1.3, the advisory commission would already have been more or less three years late in delivering its opinion at the date of its first meeting.

**F. Taxpayer participation**

The taxpayer declined to be present during the arbitration procedure even though he was invited.\textsuperscript{308} This is, to the author, interesting since one of the expressed advantages for the taxpayer with the Convention is the taxpayer’s ability to partake in the arbitration procedure as explained under chapter 5.1.3.2.

**G. Additional raised questions**

The JTPF raised some additional questions regarding the case. It discussed whether the two representatives for each of the competent authorities in the advisory commission should be from the tax assessment, tax audit or tax policy department or if it would be more appropriate to have individuals that had dealt with the case at the competent authorities as representatives, provided for in Art. 7(1) of the Convention. The advantage with choosing a individual that had dealt with the case was of course that this person would know that case and be experienced in transfer pricing and thus would speed up the procedure. The French member of the JTPF also expressed that the role of the advisory commission was not to represent any of the involved parties, but rather to deliver an opinion based on the presented methods, arguments and logic.\textsuperscript{309}

\textsuperscript{305} Op. cit., para. 18, 19.
\textsuperscript{306} Op. cit., para. 11.
H. The delivery of the advisory commission’s opinion

The advisory commission delivered its opinion at its fifth meeting on 19 May 2003 and thus within the six month time limit, counted from the date of its first meeting. As expressed the first meeting date was chosen as the date on which the case was referred to the advisory commission, mainly due to the absence of precise definition in Art. 11(1) of the Convention. But also due to practical reasons as explained.

The opinion of the advisory commission was not adopted unanimously but by simple majority, which is sufficient according to the provision in Art. 11(2) of the Convention. The competent authorities did not agree on any other alternative solution and thus the opinion became binding. The publication of the opinion was at that date not decided, but to the knowledge of the author, no official publication of the opinion has been made since then.

The chair of the JTPF concluded that considering the fact that the double taxation had been successfully eliminated showed the attractiveness of the application of the Convention.

7.2 Conclusions

As has been seen the procedures under the Convention in practice leave a number of areas unregulated, but these where agreed upon through negotiations by the involved Member States. The greatest concern is that the time limit of the Convention, one of its greatest advantages, does in reality not provide for an exact overall limit. This as there is, in accordance with the interpretation under this case, a period between the mutual agreement procedure’s end date and the start date of the advisory commission’s time limit, which is used to set up the advisory commission and is unregulated. This period could prolong the procedure under the Convention substantially. This is seen in the Electrolux case, where it took one and a half year to set up the advisory commission once the States had begun the work. However, the States did not immediately begin the work with setting up the advisory commission after the mutual agreement procedure ended and thus in total this period was more or less three years long counting from the end date of the mutual agreement procedure. This is just the amount of time that the entire procedure of the Convention would take under the alternative interpretation where the six month arbitration starts immediately after the two year mutual agreement procedure. It is unfortunate that there is so limited information published of the first case to be initiated under an advisory commission as it could have provided for guidance for enterprises as well as tax authorities.

310 Summary record of the fourth meeting of the EU Joint Transfer Pricing Forum held in Brussels on 19th June 2003, section IV, para. 11.


312 Huibregtse, & J Offermans, What is the future of the EU Arbitration Convention?, p. 80.

313 Summary record of the fourth meeting of the EU Joint Transfer Pricing Forum held in Brussels on 19th June 2003, section IV, para. 16.
8 The Joint Transfer Pricing Forum

This chapter will present the Joint Transfer Pricing Forum and its work regarding the Arbitration Convention. It will examine the Code of Conduct provided by the JTPF, what issues of the Convention it deals with and how it improves the interpretation and application of the Convention. This is to aid the analysis of the procedure under the Convention.

8.1 What the Joint Transfer Pricing Forum is

In 2001 the European Commission examined in its study “Company taxation in the internal market” whether the current application of company taxation in the internal market creates inefficiencies and obstacles. It did so on a mandate given to it by the Council in July 1999 to investigate the differences in the effective level of corporate taxation and to identify the main tax provisions that may hamper the cross-border economic activities of Internal Market. The study had also to highlight possible remedial measures.³¹⁴

The study highlighted the importance of transfer pricing tax problems as an issue for the internal market.³¹⁵ It also found that provisions of the Arbitration Convention could be improved.³¹⁶ The development of the internal market and business has since then aggra-vated the issue and it is evident that practical application of transfer prices for tax purposes is complicated and often problematic.³¹⁷ The study proposed as a remedy for the various transfer pricing problems a EU working group that would lead to better co-ordination between Member States of the application of transfer pricing methods.³¹⁸

The establishment of this working group, or Joint Forum on Transfer Pricing, with Member States and business representatives was proposed by the Commission in its communication “Towards an Internal Market without tax obstacles”. The Forum was to:

- Examine issues which can be addressed without legislative initiatives, for instance develop exchange best practice on APAs and documentation requirements.
- Consider the scope for improving and rendering more uniform transfer pricing methodologies within the OECD Guidelines.
- Examine necessary improvements to the Arbitration Convention with a view to present a proposal for a Directive in 2003, to turn it into an instrument of Community legislation.³¹⁹

Following the Council’s welcoming of this initiative on 11 March 2002, the Commission established the Joint Transfer Pricing Forum. It consists of an expert of each Mem-

ber State, a chairman and ten experts from business, there are also representatives from applicant countries and the OECD invited as observers.\(^{320}\)

The JTPF is a purely consultative expert group that is to identify pragmatic non-legislative solutions to the practical problems posed by transfer pricing practices in the EU. The results from its work will on a regular basis be transmitted to the Council, which will assess the need for an appropriate action.\(^{321}\)

The inaugural meeting of the JTPF was held on 3 October 2002 and a two year work programme was set up as the Council had suggested. The discussions showed that most of its members were of the opinion that highest priority should be given to practical solutions for a more uniform application of the Arbitration Convention to achieve higher certainty regarding the procedural issues of the Convention. This included both the mutual agreement and the arbitration procedures.\(^{322}\)

The JTPF examined procedural issues related to the improvement of the practical functioning of the Convention. This included procedures to be followed during the interim period when not all Member States had ratified the Prolongation Protocol, the starting point of the three year deadline for presentation of a case, the starting point of the two year mutual agreement procedure and proceedings during it, the proceedings during the arbitration phase and the interaction of procedures under the Convention with administrative and judicial appeals. The JTPF concluded that the optimal way to improve the practical functioning of the Convention and to deal with the various issues of it and the recommendations for those issues, was to propose a Code of Conduct with rules for the effective implementation of the Convention.\(^{323}\) The JTPF submitted a draft for this Code of Conduct to the Commission in early 2004 along with its report on its activities from October 2002 till December 2003. No work on a proposal for a Directive on arbitration was done and such proposal is not yet envisaged.

Considering the constructive results and remaining important issues on the JTPF’s work programme, the Commission in December 2004 extended the JTPF’s mandate with additional two years, from January 2005 till December 2006.\(^{324}\)

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8.2 The Code of Conduct

The Commission issued a communication on 23 April 2004 on the work of the JTPF from October 2002 till December 2003 and on the proposed Code of Conduct for the effective implementation of the Arbitration Convention. In this communication the Commission fully supported the JTPF’s recommended Code of Conduct and invited therefor the Council to adopt it as soon as possible.\footnote{COM(2004) 297 Final, p. 6.} The Council adopted the draft Code of Conduct, which was annexed in the communication, in December 2004.\footnote{http://europa.eu.int/comm/taxation_customs/taxation/company_taxes/transfer_pricing/forum/index_en.htm, 2006-03-25.} The Code of Conduct is a non-binding political commitment.\footnote{Rousselle, The EC Arbitration Convention – An overview of the Current Position, p. 14., p.17.} This is expressed in its preamble; “(...) emphasising that the Code of Conduct is a political commitment and does not affect the Member States’ rights and obligations or the respective spheres of competence of the Member States and the Community resulting from the Treaty, acknowledging that the implementation of this Code of Conduct should not hamper solutions at more global level (...)”\footnote{Code Of Conduct for the effective implementation of the Arbitration Convention (90/436/EEC of 23 July 1990), Preamble.}

The Code addresses the following issues of the Convention:

- The starting point of the three-year limit for the taxpayer to present its case for the competent authority expressed in Art. 6(1) of the Convention.
- The starting point of the two-year period mutual agreement procedure expressed in Art. 7(1) of the Convention.
- How the proceedings under the mutual agreement procedure and in the advisory commission shall be conducted.
- Recommendation for suspension of tax collection during the dispute resolution.
- Accession of the new Member States.\footnote{Op. cit., Articles 1-6.}

8.2.1 Starting point of the three year limit to present a case

The Arbitration Convention states that a “case must be presented within three years of the first notification of the action which results or is likely to result in double taxation (...)”\footnote{Art. 6(1) Arbitration Convention.} What this first notification is, as has been explained under chapter 5.1.2.1, is left for interpretation by the Convention.

The Code of Conduct however clarifies this issue by stating that the date of the “first tax assessment notice or equivalent 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 trans-
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“fer pricing adjustment” is considered as the starting point for the three-year period.331 The Code of Conduct further clarifies this issue by its annex where the Member State’s definitions of what a first tax assessment notice or equivalent are set out in both the national language and in English.332

### 8.2.2 Starting point of the two year mutual agreement procedure

The Arbitration Convention states that “if the competent authorities concerned fail to reach an agreement that eliminates the double taxation referred to in Article 6 within two years of the date on which the case was first submitted to one of the competent authorities in accordance with Article 6(1), they shall set up an advisory commission (...).”333 Articles 6(1) and 7(1) do not provide for any more specific requirement than the presentation or submission of a case to start the two year mutual agreement period. What constitutes a case as submitted or presented is left for interpretation as explained under chapters 5.1.2.1. and 5.1.2.2.

The JTPF concluded that for a case to be considered as presented or submitted and in order to provide a sufficient base for the competent authority to assess whether a complaint is well-founded, a minimum of information from the taxpayer is necessary.334 Therefore the Code of Conduct clarifies in its chapter 2 this issue by stating that “for the purpose of Article 7 (1) of the Convention, a case will be regarded as having been submitted according to Article 6 (1) when the taxpayer provides the following (…)”.335 This is followed by a list of the specific minimum information required for the case to be considered presented or submitted.

The list includes for instance identification of the involved enterprises and tax periods, relevant facts and circumstances of the case, copies of the tax assessment, details of any appeals and litigation, an explanation why the enterprise thinks that the principles set out in Art. 4 of the Convention have not been observed and an expressed undertaking that the enterprise shall respond as completely and quickly as possible to all reasonable requests made by a competent authority. Aside of the minimum information the competent authority may within two months from the taxpayer’s request, ask for additional information before the two year limit starts. The two year limit for the mutual agreement procedure then starts on the latest date of either the date of the tax assessment notice or the date on which the request and minimum information is submitted to the competent authority.336

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333 Art. 7(1) Arbitration Convention.


336 Ibidem.
8.2.3 The proceedings of the mutual agreement procedure

Chapter 3 of the Code of Conduct aims to clarify the proceedings during the mutual agreement procedure and making it more efficient and transparent by providing recommendations.

It states in its first point that “the arm’s length principle will be applied, as promulgated by the OECD, without regard to the immediate tax consequences for any particular Contracting State.” This is a clarification to the provision in Art. 6(2) of the Convention which only states that the double taxation shall be eliminated on basis of the principles set out in Art. 4 of the Convention.

The Code further clarifies some practical issues of the proceedings. It recommends that a common working language be used to accelerate the process and decrease costs due to translation and also confers upon the competent authorities to resolve the case as quickly as possible. There are also additional time limits recommended. The competent authority shall for instance be required to acknowledge the taxpayer’s request within one month from the receipt of the requirement and at the same time contact the competent authorities of the other Member State. Furthermore, if the enterprise has not submitted all information under chapter 2 the competent authority shall invite the enterprise to do so within two months of the receipt of the request. The taxpayer shall also be kept informed by the progress made during the procedure.

The Code also provides guidance for the exchange of position papers between the competent authorities. The competent authority making the assessment that results in double taxation will be required to send a position paper to the competent authorities in the other Member State describing the case, the competent authority’s view on the case and possible solutions. This position paper shall be forwarded to the other competent authority as soon as possible but no later than 4 months after the tax assessment notice or the receipt of the request and the minimum information. This is a an clarification to the rudimentary provision in Art. 6(1) of the Convention that simply states that the competent authority shall then without delay notify the competent authorities of (…) other Contracting States as was explained in chapter 5.1.2.1.

8.2.4 The proceedings of the advisory commission

The JTPF concluded that the articles 7, 9, 10, 11 and 12, containing the provisions for the functioning of the advisory commission, are not sufficiently detailed to guarantee a smooth functioning of the procedure. The Code of Conduct therefore aims at eliminating administrative uncertainties of the advisory commission. As was explained in chapter 5.1.3 provisions for practical issues of the proceedings are not provided for in the Convention. Neither is it clear when the six month time limit for the advisory com-

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mission begins. These issues may lead to substantial delaying of the procedure as was seen in chapter 7.

As was explained in chapter 7 the list of the independent persons to partake in the advisory commission was incomplete, which was a contributing factor to the delay of the procedure in the Electrolux case. The Code therefore expresses that the “Contracting States commit themselves to inform without any further delay the Secretary General of the Council of the European Union of the names of the five independent persons”. 342

As concerns the practical issues, which were examined in chapter 5.1.3, which contracting State that takes the initiative to establish the advisory commission, where it meets, how the costs are divided, the fees of the individuals in the commission, etc. The Code provides that the contracting state that issued the first tax assessment or equal that results in the double taxation, takes the initiative for the establishment of the advisory commission and arranges for its meetings, unless otherwise agreed. 343 The proceedings will be conducted in the official language or languages of the Contracting States unless otherwise agreed. 344 The Code also provides for provisions for a secretariat and its functioning, the fees and reimbursements for the involved individuals, specifically what is to be included in the opinion reached by the advisory commission and how it is to be communicated. 345

As regards one of the main questions raised, one that has also been subject to differing interpretation as examined in chapter 5.1.3; when the six month limit for the advisory commission starts is somewhat clarified in the Code. It states that “a case is considered to be referred to the advisory commission on the date when the Chairman confirms that its members have received all relevant documentation and information as specified (...)”. 346 By the specified information is meant that the “Contracting States will provide the advisory commission before its first meeting, with all relevant documentation and information and in particular all documents, reports, correspondence and conclusions used during the mutual agreement procedure.” 347 This makes it, in the author’s interpretation, clear that there is an unregulated period between the end of the mutual agreement procedure and the start of the advisory commission procedure, which can only be started once the advisory commission has been set up and received the information specified. The period between the two is unregulated. This is further analysed in chapter 9.

8.2.5 Suspension of tax

The JTPF also examined existing rules in Member States for suspension of tax collection during administrative and judicial appeals. It came to the conclusion that in almost all countries this is regulated for domestic procedures at legal level. However, for cross-border dispute resolution these regulations only exist in few countries although a significant number of tax administrations could on a discretionary basis suspend the tax collection in order to avoid double payment, even if such specific regulations do not exist. The absence of rules enabling the suspension of tax collection during cross-border dispute resolution, at least to the same extent as for domestic litigation creates an additional financial burden for the enterprises wishing to apply international double taxation resolution.

Therefore, the code provides that Member States are recommended to take all necessary steps to ensure that the suspension of tax collection is obtainable for enterprises during the procedures of the Arbitration Convention in the same way as it would be for domestic appeals.

8.2.6 The accession of the new Member States

As was examined in chapter 3.1.1 the accession of new Member States to the Convention was a very lengthy process during which the Convention was not applicable throughout the entire EU. To avoid this from happening with the accession of the new Member States in 2004, the JTPF examined possibilities to speed up the accession process. It envisaged provisional application or entry into force upon signature, in accordance with articles 25 and 24(1) of the Vienna Convention, but came to the conclusion that these would require ratification by parliament in the majority of both current and future Member States and thus would not speed up the process. The JTPF came to the conclusion that there are no legal means to speed up the accession process. The Code therefore simply states that the “Member States will endeavour to sign and ratify the Accession Convention of new EU Member States to the Arbitration Convention, as soon as possible and in any event no later than two years after their accession to the EU.”

8.3 Conclusions

As has been seen here, the Code of Conduct aims to clarify a number of the issues that have been raised with the Convention and that have been discussed in this thesis. It provides for specific interpretation of the starting point of the three year limit to present a case and also the two year limit for the mutual agreement procedure. It also gives some clarification to the start of the six month limit for the advisory commission.

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The Code, however, does not resolve all the issues of uncertainty with the Convention and it is furthermore also not a legislative act with any binding force, it is a non-binding political commitment. It is, in the author’s opinion, mainly to serve as a guide for the application of the Convention but as is expressed in parts of the Code, the Member States may agree differently.
9 Analysis

In this chapter the six questions that were put forward as the purpose of this thesis will be analysed. The first question for analysis of the thesis is the interpretation of the provision in the Prolongation Protocol for a retroactive effect of the Convention during the interim years, how it in reality was interpreted and what the legal basis could be for the different interpretations. The Second question regards the legal status of the Convention; whether the Convention is to be interpreted as a supranational or international Convention. The third question is whether the Convention could apply to double taxation arising from thin capitalisation legislation. The fourth question is how efficient the procedures under the Convention are, as regards how specifically they provide for a solution to the set out purpose of the Convention, whether there are areas left unregulated, and what the practical deficiencies of the provisions for the procedures are. The fifth question is what the general advantages or disadvantages of the mechanism to resolve double taxation under the Convention are compared to other mechanisms. The final part of the analysis provides a discussion for the author’s recommendations for the improvement of the Convention.

9.1 The retroactive effect

As was shown under chapter 3.2 the period when the Convention was not in force during the lengthy ratification of the Prolongation Protocol from January 2000 till 1 November 2004, there where differences in application and interpretation of the procedures under the Convention.

It shall also be noted that the lengthy ratification of the accession of Austria, Finland and Sweden added to the difficulty of application during this period. Those Member States had to ratify both the Accession Convention and the Prolongation Protocol and await that all of them and at least one of the old Member States ratified the Accession Convention before the Convention applied in any way to them. As then one by one the old States ratified the Accession Convention the Arbitration Convention became applicable between those old Member States and the 1995 Member States, but still pending for entry into force due to the ratification of Prolongation Protocol. To this was added of course the differences in interpretation of the effect of the retroactive provision in the Prolongation Protocol.

9.1.1 Where the request was made before 1 January 2000

The Arbitration Convention expressively states in its Art. 18 that “The Convention shall apply to proceedings referred to in Article 6(1) which are initiated after its entry into force.” The proceedings in Art. 6(1) only require for the initiation of a case that an enterprise presents its case within three years of the first notification of the action that could result in double taxation, to the competent authority of its Member State and inform that competent authority if other contracting states are concerned. Thus the literal interpretation leads to the Convention being applicable to cases even after the Con-

352 Art. 18 of the Arbitration Convention.

353 Art. 6(1) of the Arbitration Convention.
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The convention expired on 31 December 1999 as long as cases where presented at latest on this date. This as, explained in Chapter 3.2, was also the opinion of the JTPF in its report on the Convention’s re-entry into force. 354

The fact, however, that only two of the twenty-four cases where an enterprise made a request before 1 January 2000 were submitted to the advisory commission phase of the Convention shows that the literal interpretation of the Convention is not applied in practice. This could be attributed to an alternative interpretation of the Convention. Luc Hinnekens expresses that the Convention is not applicable to cases that are not finished by the time the Convention expires. He states that “As the entire procedure may last three years, cases submitted in 1998 or even in 1997 may not get arbitrated by that date (31 Dec 1999). They will have to be continued in foro domestico, if those procedures are still available under their national rules and time limits.” 355 However, this interpretation was made prior to the adoption of the Prolongation Protocol and therefore may have been influenced by the uncertainty of whether the Convention would ever be taken into effect again after its expiry. Nevertheless, it is the author’s interpretation that this uncertainty is irrelevant for the literal interpretation of the wording of the Convention which is clear in this aspect and therefore the alternative interpretation has no merit.

Another possible reason why only two cases where submitted to the arbitration phase, could be the many practical uncertainties that the Convention leaves in its procedures. As was shown in Chapter 7 it took more or less 3 years after the mutual agreement procedure was finished to set up the advisory commission in the Electrolux case.

As has been explained, the Convention only states that “if the competent authorities concerned fail to reach an agreement that eliminates the double taxation (…) within two years of the date on which the case was first submitted (…) they shall set up an advisory commission.” 356 Thereafter “the advisory commission (…) shall deliver its opinion not more than six months from the date on which the matter was referred to it”. 357 The difference in terms may lead to the interpretation that there is a period for the competent authorities to set up an advisory commission which then has six months to reach an opinion once the case is referred to it. As was explained in chapter 5.1.3 one interpretation because of this is that a case can only be referred to the advisory commission and thus set off the six month limit once it has been set up. The period in which the competent authorities shall set up the advisory commission is left unregulated and without any time limit. This means that under the Convention any time spent on setting up the advisory commission is acceptable.

This along with the issues of incomplete lists of independent persons, which also contributed to the delay in the Electrolux case, and the numerous other practical questions examined, form in the author’s interpretation the main reason for that the twenty-two

354 EU Joint Transfer Pricing Forum, report on the re-entry into force of the arbitration convention, Brussels, 30 May 2005, p. 4
356 Art. 7(1) Arbitration Convention.
357 Art. 11(1) Arbitration Convention.
pending cases from this period have so far not reached the arbitration phase. Naturally another great reason is that the Member States do not face any infringement action by the Commission or any other international or supranational body if they fail to follow the procedures of the Convention or interpret the Convention in a unfavourable way.

9.1.2 Where the request was made between 1 January 2000 and 31 October 2004

For the interim period, where the Convention had expired but was awaiting the ratification of the Prolongation Protocol in order to extend its life span with an additional 5 years and also provide for the automatic extension thereafter as explained, the Protocol stated that the “Protocol take effect as from 1 January 2000.”358 What this meant has been subject to differing interpretation in the different Member States as was examined in chapter 3.2.2.

In the author’s interpretation there were basically two distinct views of the Prolongation Protocol represented among the Member States. However, there is in the author’s view one more way of interpreting the Protocol. This other possible view is based on the provisions of provisional application in the Vienna Convention but was however in practice not clearly represented by any of the Member States.

Art. 25(1) of the Vienna Convention states that “A treaty or a part of a treaty is applied provisionally pending its entry into force if the treaty itself so provides or the negotiating States have in some other manner so agreed.”359 The Protocol does not literally express a retroactive effect, it only states that “This Protocol shall take effect as from 1 January 2000”360, this could in light of the Vienna Convention be interpreted to give the Protocol a provisional effect rather than a retroactive effect since itself so provides. However, the fact is that the Protocol states in its Art. 3.1 that all Member States needed to ratify it before it “enter(ed) into force”361. As explained by the Vienna Convention ratification means “the international act (…) whereby a State establishes on the international plane its consent to be bound by a treaty”.362 This means that as long as a State did not ratify the Protocol it had not been bound by its provisions no matter if the Protocol expressed a provisional effect. However, when an individual state ratified the Protocol it did become bound by its provisions. Thus it could have, in accordance with Art. 3.2 stating that the Protocol take(s) effect as from 1 January 2000, interpreted in accordance with Art. 25(1) VC, applied the treaty (the protocol and thereby the Convention) provisionally pending its entry into force (the point in time when all Member States had ratified the Protocol). That is the States that had ratified the Protocol would have a legal basis to apply the Convention provisionally amongst themselves.

358 Art. 3(2) Prolongation Protocol.
359 Art. 2(1) point b of the Vienna Convention.
360 Art. 3(2) Prolongation Protocol.
361 Art. 3(1) Prolongation Protocol.
362 Art. 25(1) of the Vienna Convention.
This interpretation is also supported by the fact that as the Protocol was signed on 25 May 1999 the Member States expressed a wish to continue the application of the Convention. As it would in either way enter into force after the ratification process the Member States could have applied the Convention provisionally thereby ensuring an uninterrupted application of the Convention, which also, in the author’s view, was the reason behind the Protocol’s Art. 3.2. This interpretation is also supported by the fact that the Convention’s 5 year life span started to run as of 1 January 2000 and not from the date the Protocol was ratified. This view of interpretation was, however, not clearly represented by any Member State.

Rather, some Member States were of the view that the Convention was not applicable at all during the interim period. This interpretation can, in the author’s view, be based on Art. 18 of the Arbitration Convention, which states that the Convention “shall apply to proceedings (...) which are initiated after its entry into force” Interpreted e contrario the Convention does not apply to cases before its entry into force. This means that even though the Protocol provided that itself took effect from 1 January 2000, it only entered into force at the date when all Member States had ratified it, thus the Convention also only entered into force when all Member States had ratified the Protocol.

Therefore, in this view of interpretation, there was no legal basis to invoke the Convention according to its own provisions. The only effect of the retroactive provision was that a taxpayer could make retroactive requests in November 2004 for the interim period and for cases which arose more than three years prior to 1 November 2004 and still had not been resolved through a mutual agreement procedure under a double tax treaty. This however made the retroactive provision in Art. 3(2) redundant since Art. 3(3) of the Protocol stated that “the period beginning on 1 January 2000 and ending on the date of entry into force of th(e) Protocol (1 November 2004) shall not be taken into account in determining whether a case has been presented within the time (three year deadline) specified in Article 6.1 of the Convention.” In other words the interim period, 1 January 2000 till 1 November 2004, is not taken into account when calculating the three-year deadline for submitting a case anyway. The retroactive effect according to this interpretation therefore had the same effect as the suspension of the deadline and simply allowed a taxpayer, once the Protocol entered into force, to make requests retroactively for the interim years. This even where his case related back more than three years, basically even back to 1997. This interpretation can be supported by the fact that the nature of retroactivity is the ability to take action on an issue that is in the past, and not the ability to take action before the retroactive effect enters into force.

In line with this interpretation is also the view some of the Member States took; that once the Protocol entered into force, the States would begin with the procedures under the Convention starting with the mutual agreement procedure, no matter if they already had spent time on one under the applicable tax treaty. Others that subtracted time spent on mutual agreement procedures under tax treaties from the mutual agreement procedure under the Convention did so mainly, in the author’s opinion, as a result of realising that once two years have been spent on a mutual agreement procedure under a tax treaty it would be ineffective to be given an additional two year period under the Convention

363 Art. 18 of the Arbitration Convention.

364 Art. 3(3) Prolongation Protocol
before moving to the arbitration procedure. This especially considering that the case concerned could, due to the suspension of the deadline, be dated from 1997.

In between these two “extremes” of interpretations, one giving a provisional full effect to the Convention between the States that had ratified the Protocol and the other stating a total suspension of the Convention, falls the third view, where basically the Member States would initiate mutual agreement procedures and arbitration procedures according to the Convention during the interim period but not follow the stated time limits. This view, to the author, could represent that the Convention had not entered into force, acknowledging that it was suspended, but at the same time a wish to establish an uninterrupted application of the principles of the convention to ease the application of the Convention once it re-entered into force. This view is likely to be derived from the retroactive effect of the Protocol as these Member States gave effect to the Convention before its entry into force. Thereby they gave a certain provisional effect to the Convention which as was explained was pending on the approval of the other State involved. Such an application could be base on Art. 25(1) of the Vienna Convention as “A treaty or a part of a treaty is applied provisionally pending its entry into force if the treaty itself so provides or the negotiating States have in some other manner so agreed.”

This kind of “so-and-so” application, in the author’s view, was a disadvantage for enterprises as, so far, no cases from this period have reached the arbitration phase of the Convention. Although it should still guarantee a settlement at some point, compared to a mutual agreement procedure under a double tax treaty which, as has been seen, does not.

There may, in the author’s view, be another reason for why some Member States did not apply the time limits of the Convention. As has been shown, and seen in the Electrolux case, there are differing interpretations as to when the two year mutual agreement procedure and when the arbitration phase starts. It took about three years just to set up the advisory commission in the Electrolux case. Therefore the reason why the time limits were not kept may not be due to a non-application of the Convention’s provisions but due to the lack of precise provisions in the Convention. Thus some Member States may have applied the Convention provisionally in its entirety, in accordance with the author’s initial interpretation, but simply due to the many related practical issues not so far been able to set up an advisory commission.

The author holds the first interpretation to be most in line with the purpose of the Protocol and the Convention, this also since it would have conferred more legal certainty than the third interpretation and most definitely been more beneficial for the internal market and international MNGs than the second interpretation. The author, however, recognises that it is difficult to give any of these interpretations higher merit than the others as a “correct” interpretation due to the vagueness of the provisions in both the Protocol and the Convention. It is enough for the purpose of the thesis to analyse if the differing interpretations of the applicability of the Convention during these years could have legal basis and what that basis could be.

365 Art. 2(1) point b of the Vienna Convention.
9.2 A supranational or international convention?

As was examined in chapter 3.3 the legal basis of the Convention has resulted in differing interpretations as to the legal statues of the Convention. The main controversy is the differing interpretation whether the Convention constitutes an ordinary international treaty, such as bilateral tax treaties, or if it is a supranational act with superior legal value. The main argument for the Convention being a supranational act is that it establishes a close relation to the Community.

It is clear that there is a close relation to the Community both in the provisions of the Convention and in its history. The fact that the Convention refers to the involvement of the Council as explained in chapter 3.3.1 and also seen in the procedures explained in chapter 5.1.3, the fact that the establishment of the territorial scope of the Convention refers to the Art. 299 of the EC Treaty and also the fact that the plenipotentiaries met within the Council to conclude the Convention, all point to the undeniable conclusion that the Convention has indeed a close relation to the Community. However, there is, in the author’s opinion, no reason for this fact to result in supranational status for the Convention. Furthermore, in the author’s view, the provisions involving the Council are most likely relics from the original Directive and simply were included because of lack of other options at the time. Also the argument that the chosen legal basis, Art. 293 of the EC Treaty, would establish a close relation to the community resulting in an elevated status, is in the author’s view invalid. The legal basis was in the author’s view considered, along with the involvement of Council and the Commission, most likely because the Member States wished to appease the Commission and not cut it out of the proceedings completely when turning the Commission’s proposed original Directive into a Convention. Had the Member States independently taken it upon themselves to conclude the Convention without any further involvement of the Commission and the Council, it would most likely have resulted in the Commission challenging the validity of the Convention as its conclusion could be deemed to violate the competence of the Council and Community loyalty of the Member States as was explained in chapter 3.3. Thus the legal basis was not chosen to give the Convention any supranational status in the author’s view.

Art. 293 of the EC Treaty states that “Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals (…) the abolition of double taxation within the community”. This imposes an obligation on the Member States to negotiate with each other to abolish double taxation and provides a basis for concluding bilateral double taxation treaties. As has been analysed in chapter 3.3 this article is considered a complementary provision only used when other provisions do not suffice. The Convention provides in its preamble that “The high contracting parties to the Treaty Establishing the European Economic Community, desiring to give effect to Article 220 (now Art. 293) of that Treaty, by virtue of which they have undertaken to enter into negotiations with one another with a view to securing for the benefit of their nationals the elimination of double taxation, considering the importance attached to the elimination of double taxation in connection with the

366 Art. 293 EC Treaty.
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adjustment of profits of associated enterprises, have decided to conclude this Conven-
tion...” 367

The fact that the Convention has its legal basis in this article, an article that the obligations of, as has been explained, are mainly fulfilled by bilateral tax treaties would also further the interpretation that the Convention has the legal status of an international Convention. This interpretation is also backed by the fact that ratification of the Convention and its prolongation was needed and that accession of new Member States is not automatic, as with Community law, but an accession convention is needed and it needs to be ratified by all Member States. This rather resembles the characteristics of an intergovernmental agreement than a supranational act, as can also be derived by comparison to the Vienna Convention’s rules on international treaties dealing, inter alia, with ratification and accession.

The fact is also that, as the ECJ has no jurisdiction and the Commission has no reviewing powers, there is no way of ensuring that Member States follow the provisions of the Convention and that they follow them uniformly, except for possible domestic litigation initiated by the taxpayer which as has been explained in chapter 3.2.2 is rather unlikely. As has been seen its applicability was interpreted differently during, before and after the interim years without any legal repercussions. This again would suggest that the Convention is an intergovernmental Convention as there basically is no way to force out a uniform application and the Member States are free to apply their own interpretations. The Code of Conduct is not a legislative act but as explained a political agreement and mainly serves as clarifying guidance with room for the Member States to agree differently.

One should also consider the history of the Convention and the intention of the drafters. It is explained in chapter 3.1 and 3.3 that the main reason for turning the Directive into a convention was the reluctance of the Member States to surrender their fiscal sovereignty. Thereby also avoid having transfer pricing practices being submitted to one supranational legal body, the ECJ, for scrutiny. As has been seen in chapter 2 the complexity of the arm’s length principle, the practical methods for determining a correct arm’s length price and determining where transfer pricing rules apply may have different interpretations in different Member States. These differing interpretations may be rooted in the fiscal system of the State, as it was for instance explained in Chapter 2.3.1.1 that the Swedish rules do not apply to branch and head office relations, and thus as explained the Member States did not wish to surrender this sovereignty due to lack of common rules on transfer pricing.

The Member States were also careful not to grant any powers to the procedure under the Convention which would take the case out of the hands of the domestic competent authorities. As have been expressed in chapter 5 and 5.1.3 the resolution reached by the advisory commission is referred to as an opinion in the Convention and not as a decision and the competent authorities are free to decide on another resolution. The commission is also referred to as an advisory commission, and not an arbitration commission, appointed to rather advise the competent authorities of a possible solution, than to reach a final decision on their own. This also establishes the interpretation that the Member States did not want to lose their fiscal sovereignty and have transfer pricing is-

367 Preamble to Arbitration Convention.
sues taken out of their hands. Thus the Member States clearly took a step away from granting any supranational status to the proposed mechanism by turning it into a Convention. This also leads to the conclusion that the Convention is intended to be an international treaty and not a supranational one.

The fact is also that the Convention itself lacks any provisions that would establish its superiority over domestic or international law, on the contrary it instead states in its Art. 15 that "nothing in th(e) Convention shall affect the fulfilment of wider obligations with respect to the elimination of double taxation in the case of an adjustment of profits of associated enterprises resulting either from other conventions (...) or from domestic law..." It is unlikely that a supranational act would allow domestic or international measures that circumvented its provisions, even if they did impose wider obligations. This in accordance with the principle lex superiori derogat de lege inferiori. As the Convention does by its own provisions allow for just that, it establishes by this article that it should not be regarded to have supranational powers since then this article would lose all its meaning.

It is, for these reasons, clear to the author that there is no basis for the Convention to enjoy any supranational status. However, this does not mean that the Convention should be interpreted as any other bilateral tax convention which could be overruled by a later, less far reaching tax convention, in accordance with the principle of lex posterior derogat de lege priori under the Vienna Convention. As explained the commission itself has expressed that the Convention takes precedence over bilateral tax treaties. The fact is that Art. 15, interpreted e contrario, does establish that the Convention prevails over both domestic law and international conventions, where these only offer the same or less obligations for eliminating double taxation. Thus it is clear that the Convention is not meant to be regulated by the Vienna Convention’s rule, lex posterior derogat de lege priori, in its Art. 30 for determining its ranking. Rather it shall be interpreted in accordance with the internationally established principle of lex specialis derogat de lege generali, as this would also be in accordance with its Art. 15, allowing the Convention to precede over domestic legislation and double tax treaties that do not impose as specific and wide obligations, but allowing more far reaching provisions to prevail. Thus the Convention establishes a minimum requirement for eliminating double taxation on the Member States, a minimum obligation that can not be circumvented by latter treaties. The Member States can only impose wider obligations to eliminate double taxation than the obligation arising from the Convention. The Convention in the author’s view is therefore an international agreement between all the Member States to secure for the benefit of their nationals a minimum guarantee for the elimination of double taxation.

9.3 Thin Cap applicability

As shown in chapter 2.6, thin capitalisation rules may result in double taxation as the inability to deduct interest payments and the recharacterisation of interest to dividend results in the same profits being taxed twice. The issue has raised the question whether

368 Art. 15 of the Arbitration Convention.
369 Art. 30 of the Vienna Convention.
the Convention applies to these cases where double taxation arises from thin capitalisation provisions. It also raises the question if the Convention applies to both the provisions that merely disqualify interest deductions and the provisions that also involve a recharacterisation of the transactions themselves. As seen in chapter 4 the Convention itself does not literally state that it exclusively only applies to cases of double taxation due to transfer pricing adjustments. In fact, the Code of conduct states that the deadline for submitting a request to invoke the Convention, starts on the date of the first tax assessment which results in double taxation, "for example due to transfer pricing adjustment". Due to this wording, it can be interpreted that the Code does not intend for the Convention to be applicable only to transfer pricing adjustments. Thus it is left to interpretation whether the Convention could also apply to double taxation caused by thin capitalisation.

One interpretation is that the Convention only applies to double taxation resulting from arm’s length profit adjustments and thus is no remedy for double taxation as a result of the recharacterisation of income or cost by a national tax authority. The author finds this interpretation by Terra and Wattel to be ambiguous as they also state that the Convention "covers any situation in which profits of an enterprise of one contracting state, which are included in its taxable income in that state, are also included in the taxable income of an enterprise of another contracting state, on the grounds of non-observation, by the enterprises involved, of the arm’s length principle." Nevertheless, there are interpretations that suggest that the thin cap provisions and their possible result in double taxation are not in the scope of the Convention. These interpretations are mainly based on the fact that transfer pricing and thin capitalisation are two distinctly different areas of law and that the Convention’s applicability is based on an arm’s length consideration which is not necessarily the case for thin cap provisions.

The author recognises that transfer pricing and thin capitalisation are two distinctly different areas of law, however, there are connections between the two. The wording of the Convention does in no way state that it shall exclusively apply only to the field of transfer pricing, it rather establishes the conditions that must be fulfilled for its applicability. It is in these conditions that the connections between transfer pricing and thin capitalisation provisions and their result are found. The question is whether these connections are sufficient to allow thin cap related double taxation to fall under the scope of the Convention. For this reason the wording of the Convention, setting out its purpose, scope and principles for applicability will here be analysed.

9.3.1 According to the preamble establishing the purpose

The preamble of the Convention states that the Convention has been concluded by the Member States "(…) with a view to securing for the benefit of their nationals the elimination of double taxation, considering the importance attached to the elimination of

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double taxation in connection with the adjustment of profits of associated enterprises (...)." 374

Where interests are not allowed to be deducted these interests are added to the taxable profits of the undercapitalised enterprise and subsequently taxed, thus an adjustment of profits. The interest payments are also taxed in the hands of the enterprise which receives the interest payments. Thus, since the increase in the taxable base resulting from such an adjustment may lead to double taxation, the Convention could in accordance with its purpose be deemed applicable. A similar interpretation is expressed also by Brosens. 375 In the author’s view it is clear that adding the interest to the taxable profits of the undercapitalised enterprise constitutes a profit adjustment referred to in the Preamble and such adjustment is covered by the general purpose of the Convention.

Where the transaction is also subject to recharacterisation by thin cap provisions, the debt is recharacterised as equity and the interest payments are therefore considered to be dividends. Hence the interest payments are no longer deductible and are included in the tax base of the undercapitalised enterprise and subsequently taxed. The State of the receiving enterprise might not accept the recharacterisation and thus the interests are included in the taxable profits of the receiving enterprise.

Where the thin capitalisation practices result in such recharacterisation of a debt to equity and subsequently interest payments to dividends, the issue constitutes, in a legal and direct sense a recharacterisation of a transaction and payments therefor. Hinnekens states that this thin capitalisation practice is a different legal cause of double taxation, separate from that of arm’s length transfer pricing and not in the scope of the Convention. 376 This interpretation may suggest, as Brosens states, that the avoidance of double taxation is unlikely when recharacterisation disputes arise from the application of a thin capitalisation rule, since in these cases the double taxation does not arise from the determination of prices but from application of domestic law. 377

In the author’s opinion, these arguments do not hold, since in both the case of thin capitalisation and transfer pricing the double taxation arises from the application of domestic rules. Furthermore, in both cases it is a question of an adjustment of profits in one Member State, profits (the interest) which are then included in another enterprise’s taxable profits and thus results in double taxation. Even if it is done under the legal structure of recharacterising transactions, the ultimate result is an adjustment of profits resulting in double taxation, which is the criterion used to describe the purpose of the Convention in its preamble. Thus even if transfer pricing and thin capitalisation constitute different areas of law, they have the connecting factor, in that both potentially result in a profit adjustment which may lead to double taxation, which makes thin capitalisation related double taxation fall within the purpose of the Convention.

374 Preamble to Arbitration Convention.


It is thus clear that where interest is recharacterised as a dividend the Convention can according to its purpose be applied to the double taxation as regards at least the corporate tax first levied in the subsidiary’s state due to the inclusion of the interest and the corporate tax subsequently levied in the receiving parent company’s state. However, where the interest payment is recharacterised as dividend and the receiving parent is taxed for it not only with corporate tax in its own state, but also with dividend tax in the State of the subsidiary, the question is problematic as regards the actual dividend tax. The dividend tax, unlike the additional tax levied due to the inclusion of the interest in the subsidiary’s profits, does not in the direct sense constitute a double taxation due to profit adjustments, but a tax levied because there is a dividend payment made. Furthermore the taxes covered by the Convention in its Art. 2, as examined in chapter 4.2, states that the Convention applies to taxes on income which mainly constitutes income taxes on physical persons, companies, residents, non-residents, principal taxes and surtaxes, dividend taxes are thus not included. Although, as was examined, the article is not restrictive as it states that the Convention should apply to in particular the following, it is clear from the provision in Art. 2.1 that the Convention is only intended to cover taxes on income and that Art. 2.2 only leaves the scope open for other income taxes than those listed under it. Thus dividend taxes can not be considered to fall within the purpose of the Convention.

To conclude it is clear that where an interest payment is included in the profits of both the paying and receiving enterprise and subsequently taxed with income tax in the hands of both enterprises, such adjustment of profits and resulting double taxation, no matter what thin cap provisions have resulted in the adjustment, falls within the purpose of the Convention. Dividend taxation, which forms an tertiary taxation of the original interest amount, the first and second being the income taxes levied in the two States, can however not be considered to fall within the purpose of the Convention. Thus the Convention may not be invoked to eliminate the dividend tax even where the double taxation otherwise can be resolved. This would mean that a procedure under the Convention for resolving a double taxation would have to disregard the dividend tax part and only resolve the double taxation due to income taxation. It is however likely that if a case of double taxation, or in this case triple taxation, of the same profits were to be subjected to the procedures of the Convention, the competent authorities could agree to resolve also the additional taxation due to the dividend tax. This also in recognition of that, even if dividend tax is not in line with the purpose of the Convention, the dividend taxation in such a case is not due to actual dividends but only due to a recharacterisation of interest in connection with adjustment of profits. Nevertheless, the dividend tax is deemed to be outside of the purpose of the Convention and will thus not be further involved in the analysis.

9.3.2 According to the scope of the Convention in Article 1

Art. 1(1), establishing the scope of the convention, states that "This Convention shall apply where, for the purposes of taxation, profits which are included in the profits of an enterprise of a Contracting State are also included or are also likely to be included in the profits of an enterprise of another Contracting State on the grounds that the principles set out in Article 4 and applied either directly or in corresponding provisions of the
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law of the State concerned have not been observed.”

The wording states that the Convention covers cases where, for taxation purposes, profits of an enterprise are also included or are likely to be included in the profits of another enterprise. As has been shown, where thin capitalisation provisions result in double taxation, such double taxation results from the inclusion of the same profits, the interest payment, in two enterprises and thus that criteria is in the author’s opinion fulfilled. Thus it may be concluded that double taxation resulting from thin cap provisions are also under the scope of the Convention. For this conclusion it does not matter if it is merely a case of inability to deduct interest payment or if it is also an recharacterisation as the result is the same; same profits (interest) being included in the profits of two enterprises and taxed in the hands of both enterprises with income tax. The article also states that the inclusion of the profits in the two enterprises shall be based on that the principles in Art. 4 of the Convention, or corresponding principles in domestic law, have not been observed.

9.3.3 According to the principles in Article 4

Art. 4(1) of the Convention states that the Convention shall apply where the profit adjustments, referred to under Art. 1(1), are made because “an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of another Contracting State (…) and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises (…)”

The first part of Art. 4(1) should, in the author’s opinion, be fulfilled in most thin capitalisation relations, since the financing of a subsidiary by loans from a parent company constitutes participation in capital in that subsidiary, and being associated enterprises, there is also participation in control. This has also been argued by Adonnino.

Thömmes, Stricof and Nakhai have also expressed that a literal interpretation of the third part of Art. 4(1) suggests that thin capitalisation relations between enterprises should fall within the requirement of Art. 4. It refers to profit adjustments due to conditions agreed upon between enterprises in their financial relations that differ from what would have been agreed upon between independent enterprises. Therefore it can be argued that profit adjustments under the application of thin capitalisation provisions also result from financial relations that are not in compliance with the arm’s length standard, since the financing through debt, or debt-to equity ratio, of the undercapitalised enterprise exceeds what would have been applied between unrelated parties. Thus that criterion for the application of the Convention would be fulfilled.

This interpretation, however, requires that the thin capitalisation adjustment is based on that the financial relations between the associated enterprises differ from those that would be applied between independent enterprises. This in the author’s view is gener-

378 Art. 1 Arbitration Convention.

379 Adonnino, Pietro, Some Thoughts on the EC Arbitration Convention, European Taxation, p. 405.

ally the essence of thin capitalisation provisions as the provisions aim to defend the national tax base and generally the only enterprises that would benefit fiscally from excessive thin capitalisation strategies are associated ones. Since with excessive debt comes high interest costs and if these interest payments are not kept within the MNG there is little incentives to have thin capitalisation arrangements. Thus, such financial relations of excessive thin capitalisation would generally never occur between independent enterprises, at least not for fiscal reasons. This also in light of the considerations behind thin cap, which are explained under chapter 2.6.

In the author’s opinion, thin cap provisions should generally be based on arm’s length considerations and even general debt-to-equity ratios constitute an expression for what the national legislators consider to be a level of debt that would be applied between independent enterprises. Anything above that level is by the legislator considered to be due to fiscal considerations due to the association between the enterprises and would not have been applied between independent enterprises.

The principles of Art. 4 of the Convention, as has been explained, are defined in identical terms as those in articles 7(2) and 9(1) of the OECD Model Convention. The Convention does not provide for how an adjustment of enterprise profits shall be made in order to be in accordance with the arm’s length principle. As examined in chapter 3.3.2.3, there is a close relation between the Convention and the tax treaties as the Convention refers to them for interpretation of undefined terms. This allows these Convention principles to be interpreted in accordance with the OECD Model Convention. Furthermore, as was explained under 3.3.2.4, the OECD Guidelines are generally considered to be the most important document of transfer pricing and its importance is also shown by the approval given to it by the OECD Member States. In the author’s opinion, the reference to the tax treaties and the exact same wording reflects not only a close relation in interpretation between articles 7(2) and 9(1) of the OECD Model Convention and Art. 4 of the Convention but in fact that it is the same principle with the same applicability. Furthermore the Code of Conduct on the Convention has also stated that “the arm’s length principle will be applied, as promulgated by the OECD, without regard to the immediate tax consequences for any particular Contracting State.” Thus it is clear that the applicability of the Convention should be interpreted in line with the principles in the OECD Model Convention, the Guidelines and subsequently also the Commentaries to the Model Convention. Hinnekens also states that there is considerable weight attached to the OECD Commentary regarding the interpretation of Art. 9 and by the same token the interpretation of Art. 4 of the Convention.

The OECD Commentary on Art. 9.1 states that there is an interplay between the tax treaties and domestic rules on thin capitalisation, which is relevant to the scope of Art. 9.1. The Commentary on Art. 9.1 states that “the Article is relevant not only in determining whether the rate of interest provided for in a loan contract is an arm’s length

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382 Code Of Conduct for the effective implementation of the Arbitration Convention (90/436/EEC of 23 July 1990), chapter 3, section 3.1, point a.
384 OECD (2003) Commentary on Art. 9 para. 3.
rate, but also whether a PRIMA FACIE loan can be regarded as a loan or should be regarded as some other kind of payment, in particular a contribution to equity capital.” Therefore, as the principle set out in Art. 9.1 of the OECD Model Convention does apply to thin cap provisions, the principle set out in the Convention’s Art. 4 should be interpreted in the same way as it, as explained, should be considered to have a close relation to it and in fact, can be deemed to be the same principle. It is in the author’s opinion thus clear that double taxation resulting from thin cap provisions, no matter if it is a question of mere inability of deducting interest or if it also is a recharacterisation of that interest, do fall within the principles for applicability of the Convention.

Yet another argument for the applicability of the Convention to double taxation arising from thin cap provisions is that there was an expressed wish in the Commission’s staff working paper on company taxation in the internal market, that it should be made clear that the Convention covers thin capitalisation rules.

### 9.3.4 The overall applicability

Thus it can be concluded by the analysis above that there are definite connections between transfer pricing provision and thin cap provisions and that these connections are sufficient to bring double taxation relating from thin capitalisation provisions within the purpose, scope and principles for applicability of the Convention. Even if thin capitalisation is a different area of law, the resulting conditions from it establish the needed conditions for the applicability of the Convention: double taxation in connection with adjustment of profits of associated enterprises, profits that for purposes of taxation are included in the profits of an enterprise of a Contracting State and also included in the profits of an enterprise of another Contracting State, due to the fact that an enterprise of a Contracting State participates, if nothing else at least, directly in the capital of an enterprise of another Contracting State and conditions are imposed between the two enterprises in their financial relations which differ from those which would be made between independent enterprises.

Therefore it can be concluded that double taxation cases due to thin cap provisions do fall under the Convention in accordance with its wording. However, in the author’s opinion, it is in reality for the time being unlikely that the Member States will apply the Convention to these cases. This because as was seen in chapter 4.3.1 the Convention does not apply to cases of double taxation where its terms are interpreted differently, that is the applicability of the Convention can not be interpreted under its own procedures. Thus even if a State would interpret the Convention to be applicable to thin cap related double taxation, the applicability falls if the other State in the case does not share this interpretation. For instance the mentioned statement under Point 1 in the Code of conduct stating that the deadline for submitting a case starts on the date of the first tax assessment resulting in double taxation, for example due to transfer pricing adjustment, has a footnote where the Italian tax authority member expressed that he considers the date of the first tax assessment notice reflecting a transfer pricing adjustment resulting in double taxation as the starting point of the deadline. This as he considered that the

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Convention should be limited to those cases where there is a transfer pricing adjustment. It is apparent that this view was not shared by the JTPF to the extent where they would have used the same wording in the actual provision in the Point or at least not used the transfer pricing adjustment only as an example.

Furthermore, as seen there are numerous differences of interpretation as regards the Convention, its status, procedures and applicability, thus it is unlikely that any tax authority would wish to add this issue to the list they may have to negotiate before being able to initiate the procedures. The applicability to thin cap provisions of the Convention, although clearly in accordance with its wording, will therefore in the author’s view need a clarification, preferably from the JTPF, before such cases will be able to be referred to the Convention.

9.4 The Convention’s procedure

As was seen in chapter 5 there are numerous rudimentary areas in the Convention setting out the procedure that are left to interpretation. There are also parts of the procedure that are left completely unregulated and interpretation as well as chosen application is left to the discretion of the competent authorities. Some of these have been eliminated by the Code of conduct, although it should be noted the Code is not a binding legislative act but a political agreement.

9.4.1 The starting point of the three year deadline

The first issue is when the actual three year deadline for an enterprise starts. The Convention only specifies that “the case must be presented within three years of the first notification of the action which results or is likely to result in double taxation”. What this first notification is, as was shown, has differing interpretations. Some guidance may be derived from Art. 5 which states that “Where a Contracting State intends to adjust the profits of an enterprise in accordance with the principles set out in Article 4, it shall inform the enterprise of the intended action in due time.”

The issue has however been clarified in the Code of conduct, which states that the date of the first tax assessment notice or equivalent which results or is likely to result in double taxation within the meaning of Article 1, e.g. due to a transfer pricing adjustment is considered as the starting point for the three-year period. Each Member State’s definition of the relevant event is included in the annex to the Code. Thus this issue of uncertainty has been resolved. The Member States are in the Code also recommended to apply the same definition of the starting date for the mutual agreement procedures under tax treaties.

What is meant by the criteria likely to result is not developed in the Code and does still leave some uncertainty. However, as what constitutes the actual first notification has


388 Art. 6(1) Arbitration Convention.

389 Art. 5 Arbitration Convention.
been defined, there may be no uncertainty as to what is required for the start of the three year deadline. Thus there can be no differing interpretations as to how high level of certainty of double taxation an enterprise must have before being able to make requirements to invoke the Convention. The criterion likely to result is in the author’s opinion, only meant to allow an enterprise to make claims where the other Contracting State has been notified in accordance with Art. 5, as explained in 5.1.1, but the Contracting State has not yet given notice of whether it agrees to the adjustment and thus will make a corresponding adjustment eliminating the double taxation, or that it disagrees with the adjustment.

9.4.2 The presentation of a case and start of the two year mutual agreement procedure

The Convention states in Art. 6(1) that “where an enterprise considers that (...) the principles, set out in Article 4 have not been observed, it may (...) present its case to the competent authority.” 390

In what form the enterprise should present its claim and what documents and arguments to include is not regulated in the Convention. As shown there have been differing interpretations to this issue and mainly domestic regulations have been applied. The convention further states in its Art. 7(1) that the competent authorities must “reach an agreement that eliminates the double taxation referred to in Article 6 within two years of the date on which the case was first submitted to one of the competent authorities in accordance with Article 6(1)” 391

It is clear that these two articles refer to the same action, the presentation/submission of a case within the three year deadline in order to start the two year deadline for the mutual agreement procedure. It is in the author’s opinion unfortunate that two different terms were chosen to describe the same action, submission and presentation of a case, as this leads to inconsistency and uncertainty and may also further already differing interpretations of when the two year mutual agreement procedure starts, explained in chapter 5.1.2.2. What constitutes a case as submitted or presented is not defined.

The Code of conduct has solved this issue of uncertainty by giving a list of minimum information that the enterprise must supply the competent authority with for the case to be considered as submitted / presented. The two year mutual agreement procedure then starts on the latest of the two dates of either the date of the tax assessment notice or the date on which the competent authority receives the list with the minimum information. Through this it also rules out any possibility for the terms submitted and presented to be interpreted to refer to two different actions. Thus this area of uncertainty in the Convention has also been eliminated.

9.4.3 The start of the six month advisory commission procedure

The main issue of the advisory commission procedure is the question when the six month time limit for the commission starts. The Convention states that "If the compe-
tent authorities concerned fail to reach an agreement that eliminates the double taxation (...) within two years of the date on which the case was first submitted to one of the competent authorities (...), they shall set up an advisory commission”. It further states that “the advisory commission (...) shall deliver its opinion not more than six months from the date on which the matter was referred to it.” As these two provisions clearly refer to two different actions, the first to the setting up of the commission and the second to the referral of the case to the commission the question becomes if a case can be referred to the advisory commission before it has been set up. As seen there are differing interpretations on the issue. One interpretation is that the case is referred to an advisory commission at the moment the competent authority is required to set the commission up. The six month deadline would thus start to run the moment the two year mutual agreement period ended. This would be beneficial for the clarity of the Convention as there would be a definite time limit for the procedures under it and a case would be guaranteed to be resolved within three years from submission. The definite time limit to resolve a case of the Convention was also, in the author’s view, one of the intended advantages of the Convention. This interpreted by all the other time limits that the Convention imposes, for the presentation of the case, the mutual agreement procedure, the advisory commission and the final decision of the competent authorities.

The alternative interpretation states that a case can only be referred to the advisory commission, and the six month deadline started, once the competent authorities have set up the advisory commission. This was also the interpretation by the French and Italian tax authorities in the Electrolux case. This interpretation puts a “hole” in the Convention’s procedures that is left unregulated by any time limit and thus overthrows the advantage with the other imposed time limits to complete a case. If in fact, as is the view of the author, one of the intended advantages of the Convention compared to mutual agreement procedures under tax treaties was a time limit for the resolution of a case, that advantage is greatly reduced by this unregulated period. As seen this “hole” resulted in more or less a three year period to set up the advisory commission before the case was referred to it and the six month time limit started. Thus it took about six years to resolve the case, twice the time it would be allowed to take in accordance with the first interpretation.

The Code of Conduct does not clearly resolve this issue. However, it states that “a case is considered to be referred to the advisory commission on the date when the Chairman confirms that its members have received all relevant documentation and information as specified (...).” By the specified information is meant that the “Contracting States will provide the advisory commission before its first meeting, with all relevant documentation and information and in particular all documents, reports, correspondence and conclusions used during the mutual agreement procedure.” Thus it can be concluded that the six month deadline is intended to start only after the advisory commission has been set up, as this provision requires that there is an advisory commission,

392 Art. 7(1) Arbitration Convention.
393 Art. 11(1) Arbitration Convention.
with elected chairman and members, which receive the specified information. Therefore, the Code of conduct confirms the interpretation that there is an unregulated period between the end of the mutual agreement procedure and starting point of the six month advisory commission procedure.

Since the area is unregulated the time spent on setting up an advisory commission could in theory be even more lengthy and thus it can be questioned whether the Convention really holds an advantage to the mutual agreement procedure under a tax treaty as regards the time in which as case may be resolved.

It is most unfortunate that this “hole” is left unregulated and the author believes that its of great importance that it is clarified by an imposed deadline for the setting up of the advisory commission. This could be done by amending the Convention, but as this would call for ratification by all Member States, as with the amendment for automatic extension in the Prolongation Protocol, it could result in a long period where the issue would still be unregulated. A better solution would be that the JTPF would issue another Code of Conduct.

As was explained in chapter 5.1.3 there are also numerous practical issues that are left unregulated by the convention; which competent authority that shall take the initiative to establish the advisory commission, where the advisory commission is to meet, who will support the costs of the procedure, what is the level of fees of the Members and Chairman, what will be the content of the opinion and what are the conditions for its publication and which language will be used. These issues have been clarified under the Code of conduct which thereby should shorten the time needed during the discussed unregulated period.

The Electrolux case also showed that there were issues with electing the independent persons as the list of independent persons was not complete and not up to date. The Code of conduct has also addressed this issue, although only by the vague statement that the “Contracting States commit themselves to inform without any further delay the Secretary General of the Council of the European Union of the names of the five independent persons.” However, the Code does solve the issue with the list being outdated as it states that the Secretary General of the Council will address every year a request to Contracting States to confirm the names of their independent persons of standing or give the names of their replacements. Thus this issue, that furthered the delay of the procedures during the Electrolux case, has now been dealt with and should not constitute a delay during the unregulated period, thus ensuring that the competent authorities smoothly can set up the advisory commission.

**9.4.4 Inapplicability**

As has been explained the Convention does not apply to cases where there is a difference of interpretation of its terms. Cases where the competent authorities disagree on findings of residency, permanent establishments, whether there is an association and

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396 Code of conduct for the effective implementation of the Arbitration Convention (90/436/EEC of 23 July 1990), chapter 4, section 4.1, point a.

what constitutes an enterprise may thus not be resolved under the Convention as it does not apply to cases where double taxation is caused by different interpretation of its own terms. That is it can not be applied to determine, for instance, what constitutes residency. This due to Art. 3(2) of the Convention which states that “any term not defined in this Convention shall, unless the context otherwise requires, have the meaning which it has under the double taxation convention between the states concerned”.

Tax treaties which include Art. 3(2) of the OECD Model Convention may also refer to domestic laws for the interpretation of these terms.

This is unfortunate since, as it has been explained in chapter 2, the complexity of determining what constitutes an association and what constitutes a permanent establishment may lead to different application of transfer pricing rules and may result in adjustments that the corresponding State will not agree with and thus not make a corresponding adjustment. These differences may lead to double taxation that run the risk of not being resolved under the Convention due to the inapplicability of the Convention to cases of double taxation caused by differences of interpretation of its terms. This could also according to Hinnekens offer an easy excuse to competent authorities for refusing to initiate procedures under the Convention. Although, in the author’s opinion, the wording unless the context otherwise requires could be interpreted to mean that the context of the Convention, aiming at resolving double taxation due to profit adjustments, should require that the Convention’s procedures are applied also to interpret such terms as residency and association if that is required to resolve a case. However, this interpretation seems unlikely as the criterion is an exception from the rule of having undefined terms interpreted in accordance with the tax treaties and the possibility of interpreting such terms under the Convention is not expressed anywhere in the Convention, leaving the Convention inapplicable to such cases. This issue should be clarified.

As was seen in chapter 4.3.3 the Convention does not apply to cases of double taxation where legal or administrative proceedings have resulted in a final ruling that one of the enterprises concerned is liable to a serious penalty. Thus the Convention aims to exclude from its application deceitful transfer pricing practices that aim for tax manipulation and tax evasion. The main concern with this provision is that it refers to the domestic law of each Member State for the definition of what constitutes a serious penalty in that Member State and thus there are differences in what is considered to constitute a serious penalty. As was shown some Member States require dolus, whereas others only require culpa. This divergence of interpretation leads to uncertainty and a differing applicability of the Convention throughout the EU and also leads to unequal treatment of enterprises.

The fact is also that where an enterprise is subject to serious penalty, it is already penalised under the domestic laws with such penalties that have been considered adequate from a legal point. To subject the enterprise to further penalty by not allowing it to have recourse to the Convention for resolving the double taxation, adds to its penalty the double taxation of its profits, which to the author seems legally unjust. This also since an

398 Art. 3(2) Arbitration Convention.


400 Art. 8(1) Arbitration Convention.
enterprise that may be subject to a similar serious penalty, but for other reasons than
transfer pricing and may thus not face double taxation, will only be penalised with the
domestic penalty. To this adds the consideration that since there is such difference in
what actually constitutes a serious penalty, the penalties imposed could, in the author’s
opinion, in reality be lower than the amount the enterprise is double taxed with.

In a transfer pricing questionnaire in June 2000 the tax administrations of the then 15
Member States where asked on their experience with the Convention in the years 1995-
1999. As the Convention was only applicable between the original 12 Member States in
those years, these where the only States that could provide information. The States re-
ported that hardly any cases were rejected and that no Member State had used the seri-
Even so it is the author’s opinion that the potential unjust treatment of an enterprise due to the article, and the fact that non-compliance with trans-
fer pricing regulations should not be punished by penalties disguised as double taxation
as expressed in chapter 4.3.3, motivates the removal of the provision. This idea has also
been put forward in the Commission’s staff working paper on company taxation in the

Another provision in the Convention potentially leading to inapplicability is, as seen in
chapter 5.1, that the competent authority shall endeavour to resolve the case only if the
complaint \textit{appears to be well-founded}. What constitutes a complaint as \textit{well-founded} is
left to interpretation. According to Hinnekens the provision is not meant to enable com-
petent authorities to decide “\textit{within the scope of their due discretion whether mutual
agreement procedures should be initiated}”.\footnote{Hinnekens, The European Tax Arbitration Convention and its Legal Framework II, p. 285.}
The competent authorities are only al-
lowed to refuse access to the Convention on grounds relating to the Convention, this in
accordance with the international right for taxpayers to present a case to the competent
authority in view of an international resolution. This right is only subject to the review
of the procedure under the Convention and the good faith character of the request.\footnote{Ibidem.}

In the author’s opinion, this interpretation is valid as the criteria of a complaint being \textit{well-
founded} in the author’s view should be put into the context of the rest of Art. 6(1). The
article lays down the criteria that “\textit{where an enterprise considers that, in any case to
which th(e) Convention applies, the principles set out in Article 4 have not been ob-
served, it may (...) present its case (...)within three years}.”\footnote{Art. 6(1) Arbitration Convention.}

Thus whether a case \textit{appears to be well-founded} should be determined in accordance with the criteria that the
Convention applies to the case, that the principles in Art. 4 appears not to have been ob-
served and that the case is presented within the deadline and that the presentation in-
cludes the list of minimum information set out in the Code of conduct.

However, the differences in interpretation of the Convention, due to the vagueness of its
terms is likely to disallow a uniform interpretation in accordance with the stated one.
Thus what is meant by a \textit{well-founded} complaint would also need clarification.
9.5 The Convention compared to other mechanisms

9.5.1 Domestic litigation

As is seen in chapter 6, litigation at domestic courts is not considered suitable. Such litigation tends to be very lengthy due to the considerable amount of information to process. Given that a national court may not have access to the same level of transfer pricing expertise, or at least not to the same extent, as the advisory commission under the Convention, cases may not be concluded as efficiently and competently. Litigation at domestic courts also only deals with the problem from the perspective of its own jurisdiction and may not take into account differing views on establishing arm’s length prices. Therefore an adjustment is more likely to be sustained as there may be no other views of interpretation on arm’s length price. As the domestic litigation is not focused on the resolution of double taxation, but rather on the correctness of the tax authority’s adjustment, with the elimination of double taxation as a by-product, the sustaining of an adjustment will also leave the double taxation unresolved. The objective of determining the correctness of the adjustment also results in that the litigation will be a win or lose mechanism, in the end of which the adjustment may not be removed, or removed completely, still leaving the enterprise with double taxation and the costs for litigation. Under the Convention’s procedure the objective is the elimination of double taxation thus guaranteeing the taxpayer that the double taxation will be resolved. Furthermore, as the enterprise is not a party, it does not face any costs for the procedure. There is no such guarantee under domestic legislation and the enterprise may spend a long time on a costly procedure without having the double taxation resolved.

Although the enterprise may still have the right to invoke the Convention’s procedures after the litigation, the fact is that the domestic litigation could prolong the proceedings under the Convention, as was seen in chapter 5.1.2.3, since the two year limit for the mutual agreement procedure is computed from the date on which the judgement of the final court of appeal is given. Furthermore, if an enterprise has resorted to domestic judicial remedies as well as the Convention, and the domestic laws of a Contracting State do not permit the competent authorities of that State to derogate from decisions of their judicial bodies, the competent authorities are only required to set up an advisory commission if the time provided for an appeal has expired or if the enterprise has withdrawn such an appeal before a decision was given. Thus, in the author’s opinion, an enterprise has little to benefit from subjecting the case to domestic litigation compared to subjecting it to the procedures under the Convention. It was also stated in the Commission’s staff working paper on company taxation in the internal market that it is unlikely that litigation would be applied as a general double taxation avoidance mechanism.

9.5.2 Mutual agreement procedure

The Mutual agreement procedure provided for by tax treaties in accordance with the OECD Model Convention has a wider scope of application than the Arbitration Convention and transfer pricing issues are just one of three areas where the mutual agree-

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406 Art. 7(3) Arbitration Convention.

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Arbitration procedures is generally used. The two other areas include questions regarding interpretation or application of the tax convention and elimination of double taxation in cases otherwise not provided for by the tax convention. Thus the procedure has the advantage compared to the Convention that it can interpret questions regarding the tax treaty’s own interpretation and application. The mutual agreement procedure is also so far a better established mechanism for resolving double taxation than the Convention, although the fact that only one case has been settled under the advisory commission procedure does not mean that only one case has been settled by the use of the Convention. A number of cases have also been resolved during the mutual agreement procedure under the Convention. 408

There are a number of specific deficiencies of the mutual agreement procedure, provided for by tax treaties in accordance with the OECD Model Convention, compared to the mechanism under the Convention. The main deficiency is that the mutual agreement procedure does not oblige the competent authorities to reach an agreement and solve the double taxation issue, it merely obliges them to endeavour to reach an agreement. The mutual agreement procedure does therefore in no way guarantee that the double taxation will be resolved. This is a great disadvantage compared to the Convention which guarantees the taxpayer that the double taxation will be resolved.

Another disadvantage is that there are no time limits under the mutual agreement procedure, which therefore may take long time to complete. However, it has been shown that the Convention does in fact not have a time limit for the overall procedure either, as the time between the end of its mutual agreement procedure and the start of the advisory commission procedure is left unregulated. This period can be substantially prolong the procedure as was seen during the Electrolux case, which in total took about six years to resolve. Thus until this “hole” in the Convention’s time limits is regulated, it is uncertain whether the Convention truly has an advantage compared to the mutual agreement as regards the time spent. However, one advantage is that up to point of its mutual agreement procedure the Convention does provide for an overall time limit of two years, starting at the date of the presentation of the case, to resolve the double taxation. As the tax authorities may be reluctant to have the case taken out of their hands they will have an incentive to resolve the double taxation before the end of the mutual agreement procedure. Thus many cases may be resolved during the two year mutual agreement procedure, which does provide for a time limit, and would thus be more beneficial for enterprises than mutual agreement procedures under the applicable tax treaty.

Taxpayer participation is very limited under the mutual agreement procedure in tax treaties. The taxpayer has the right to submit a request to initiate the procedure, but has no specific right to participate. 409 This is a disadvantage compared to the Convention where the enterprises, in accordance with Art. 10(1) of the Convention, may provide the advisory commission with any information, evidence and documents. The enterprises are furthermore also, according to Art. 10(2) of the Convention allowed to appear or be represented before the advisory commission, with the implied right to improve and refute evidence. Although the enterprises only have the right to participate in the advisory commission procedure, this right to participate is still a great advantage. This, as ex-


409 OECD Guidelines, Chapter IV, section C, paras. 4.56-4.57.
plained, since the taxpayer is not indifferent to how double taxation is resolved since there is a difference for an MNG where the profits are allocated.

Although this right is an improvement it should, in the author’s view, not be seen as possibility for the enterprises to participate in every case. As was explained many cases may be resolved already during the mutual agreement procedure of the Convention where the taxpayer does not have a right to participate, although it may, where appropriate, be invited by its competent authority to make a presentation as the Code of Conduct sets out.\textsuperscript{410}

The Code of Conduct also provides that Member States are recommended to take all necessary steps to ensure that the suspension of tax collection is obtainable for enterprises during the procedures of the Arbitration Convention.\textsuperscript{411} This is a possible advantage over the procedures under tax treaties where there may be no such procedures or incentives. Although the Code gives a vague incentive to this effect by stating that it would be appropriate to extend these measures also to the procedures under the tax treaties.

The publication of resolved cases, which could serve as guiding precedents, is a disadvantage that both mechanisms share as neither have an expressed obligation to publish resolved cases. However, the Convention at least provides for the possibility to do so and could thus eventually lead to the publication of a number of cases, establishing a transfer pricing guidance.

For these reasons it is clear that the Convention’s mechanism to resolve double taxation has numerous advantages over the mechanism in double taxation treaties. With the main advantage being that it does not settle with the competent authorities merely endeavouring to resolve a case. It was also stated in the Commission’s staff working paper on company taxation in the internal market that the Convention constitutes a major improvement compared to the traditional mutual agreement procedures because it includes an arbitration phase for cases where competent authorities cannot agree upon a solution.\textsuperscript{412}

### 9.5.3 Advance pricing arrangement

Advance pricing arrangements are, in the author’s opinion, not mechanism for resolving transfer pricing related double taxation disputes, they are rather means to avoid the double taxation dispute altogether.

An advantage compared to the Convention’s mechanism is that APAs provide a certainty for the taxpayer of how transfer pricing issues are going to be treated before the transactions take place. Furthermore, they are concluded for a specific period of time during which the enterprise is assured that the transactions will not be questioned as

\begin{itemize}
  \item \textsuperscript{410} Code of conduct for the effective implementation of the Arbitration Convention (90/436/EEC of 23 July 1990), Point 3(1)c.
  \item \textsuperscript{411} Code of conduct for the effective implementation of the Arbitration Convention (90/436/EEC of 23 July 1990), Point 5.
\end{itemize}
long as the enterprise follows the arrangement. Thus APAs lead to certainty in the otherwise often uncertain and problematic transfer pricing area and may prevent time-consuming and costly examinations and litigation for transfer pricing issues.413 As was stated in chapter 5, 60% of multinational enterprises’ tax managers identify transfer pricing as their main tax problem.414

APAs also have the advantage of involving the taxpayer to a greater extent than the procedures under the Convention. This as in an APA the associated enterprises will normally be expected to provide the tax authorities with the transfer pricing methodology considered by them most reasonable under the circumstances and documentation supporting their methodology. The associated enterprises are typically also allowed to participate in the process of obtaining an APA, by presenting the case and negotiating with the tax authorities concerned. The APA thus also provides a means for the associated enterprises and the tax authorities to consult and cooperate in a non-conflict and preventative setting easing the flow of information and thus aiding a more accurate and objective review. This is an advantage compared to the participation in the procedure under the Convention where the enterprise may not even be involved if the case is resolved during the mutual agreement procedure.

However, this advantage could also be a disadvantage as the enterprises may be faced with, costly and time consuming procedures, where the enterprise is required to prepare higher levels of documentation and partake in the procedures to a greater extent than is required under the Convention’s procedures.

Another disadvantage compared to the Convention is that an APA can be invoked technically by any and all enterprises that have cross-border, intra-group transactions and not just by those that actually are subjected to transfer pricing adjustments. This could pose a much larger strain on the tax authorities’ auditing resources than the Convention’s procedure and prove overwhelming for the tax authorities, diminishing the efficient conclusion of APAs. This also since, as explained under chapter 6.3 the work is not focused on the correctness of a specific, or a number of specific, transactions, but is to predict arm’s length transfer prices for a specified period, which could involve considerably more research. Furthermore the APA is not a “conclude and forget” mechanism as the Convention’s procedure, but as the arrangement is concluded for a period of time the tax authority may have to monitor the continued applicability of the arrangement during that period.

As was explained in chapter 6.3 APAs are generally not very developed in the EU and only a few Member States have established formal APA programmes. Furthermore APAs are primarily used by large enterprises for complex transfer pricing issues involving for instance intangibles and cost-sharing and often involving non- Member States.415

For these reasons, in the author’s opinion, APAs do not provide for a mechanism that alone could deal with all transfer pricing double taxation. They can only be used to supplement other mechanisms. This also as it may take considerable time for the competent

413 OECD Guidelines, Chapter IV, section F, paragraph 4.143-4.145.
414 Terra & Wattel, European Tax Law, p. 403.
authorities to work out an arrangement, during which the enterprises may have concluded several transactions that may be subjected to adjustment. It is also not certain that an APA can be concluded in time to immediately apply after the end of the applicability of a preceding APA and thus there too will be a period where the enterprise concludes transactions that may be subject to adjustment. Unilateral APAs are insufficient to guarantee that a transaction will not be challenged as it only involves one of the States and thus the other State may still adjust a transaction. It seems to the author also unlikely that a MNG could conclude sufficient number of bilateral APAs, or a multilateral APA of such magnitude that would cover all possible cross-border transactions, given all possible kinds of association, a global MNG may face.

9.6 Recommended improvements for the Convention

As seen there are, even after the Code of conduct, still numerous unresolved issues with the Arbitration Convention that would need clarification. The fact that such clarification could come in the form of a new code of conduct where it would be clarified how the Convention relates to other tax treaties, if it takes precedence as an act of higher status or, as the author believes, it takes precedence due to its lex specialis nature and form of a minimum guarantee. It would further clarify whether the Convention applies exclusively to transfer pricing adjustments or, as the author suggests, also cases of thin cap are included. It is also imperative for the function of the Convention that the unregulated period between the end of the mutual agreement procedure and the start of the advisory commission procedure is clarified. A second code of conduct could for this end set out a time limit for the setting up of a advisory commission. The escape hatches under the Convention should also be clarified, that is whether a complaint is well-founded if it meets the criteria set out in the article, as is the author’s interpretation. A second code could also give guidance for how triangular situations are best resolved since as was seen in chapter 4.3.2 the provisions of the Convention are not clear on whether the procedure under the Convention should deal with cases bilaterally or as a joint procedure. Although, this could be left to be decided by the competent authorities on a case to case basis, otherwise there might be a risk that a too complex case, with more than two parties, will not be able to be finished within the set out time limits.

The serious penalty exclusion should be removed from the Convention. This could be done in accordance with Art. 21 of the Convention, which states that “each Contracting State may, at any time, ask for a revision of this Convention. In that event, a conference to revise the Convention will be convened by the President of the Council of the European Communities.” It could also be done by using a separate convention for this end, similar to the prolongation protocol which, as explained, also amended the Convention.

A new code of conduct would, however, still not guarantee a uniform interpretation and application of the Convention and its terms and even if guidance can be given, a code still lacks a binding legal effect. Furthermore, as the advisory commission may consist of different person from case to case there is a risk of cases being resolved by application of different transfer pricing methods, as explained in chapter 5.1.3.1, leading to inconsistency and lack of predictability and similar treatment of taxpayers in the advisory

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416 Art. 21 Arbitration Convention.
commission’s opinions. This also reduces any published opinions ability to give guidance. There are possible solutions for these problems as well.

9.6.1 Subjection to interpretation by the ECJ

Rousselle suggested that one way to improve the function of the Convention would be to allow the ECJ to have jurisdiction.\(^{417}\) That is, where the member states could not reach an agreement during the mutual agreement procedure, or regarding the applicability of the Convention, the case would by the member states be referred to the ECJ.

It was stated in the Commission’s staff working paper on company taxation in the internal market that "The practical application of the Arbitration Convention could certainly be improved and its provisions made subject to interpretation by the Court."\(^{418}\) Subjecting the Convention to the jurisdiction of the ECJ could be done in the same way as was envisaged for a bilateral tax convention between Germany and Austria, by using the provision in Art. 239 of the EC Treaty.\(^{419}\) This article states that "the Court of Justice shall have jurisdiction in any dispute between Member States which relates to the subject matter of this Treaty if the dispute is submitted to it under a special agreement between the parties."\(^{420}\) The two criteria of the Convention are that the dispute is between Member States and that the dispute relates to the subject matter of the EC Treaty.\(^{421}\) This would in the cases that are subjected to the Convention’s procedures be fulfilled as the Convention only applies to Member States and since the Convention originally was planned as a Directive it is apparent that disputes in the scope of the Convention relate also to the subject matter of the EC Treaty. This is also supported by the provision for the abolition of double taxation under Art. 293 of the EC Treaty and the provisions under Art. 3 of the EC Treaty for the creation of an internal market where the obstacles for free movement of goods, services and capital are abolished.\(^{422}\)

For this end the Convention would be amended with a clause that provided that a case would be subjected to the ECJ if the competent authorities could not reach an agreement during the mutual agreement procedure or if they could not agree the applicability of the Convention. Thus the advisory commission procedure would be replaced with the subjection of a case to the ECJ. Such revision of the Convention could either be done in accordance with its Art. 21 or with the use of a separate convention for amending the Convention. The amendment would result in that the case would not be given a solution by the advisory commission, which the States where free to derogate from, but that the case would be given a final resolution by the ECJ.


\(^{420}\) Art. 293 EC Treaty.

\(^{421}\) Mario, Züger, The ECJ as Arbitration Court for the New Austria Germany Tax Treaty, pp. 101-102.

\(^{422}\) Articles 3 and 293 EC Treaty.
This would improve the Convention as it would ensure a uniform interpretation of the terms and application of the Convention thus eliminating the problem with differing interpretation of the Convention and the inapplicability where Member States disagree on undefined terms. This would pose a great improvement since the fact that there is no way to guarantee that the provisions of the Convention are precisely followed, partly since there are uncertainties regarding the precise interpretation but also partly since there is no organ that could provide a legally binding uniform application of the Convention impedes the efficiency of the Convention. This is clearly seen in practice as so far only one case has been resolved by the advisory commission and even though a number of cases have been solved during the mutual agreement procedure, the problems with the differing application are apparent.

It would also allow cases to be solved with application of uniform methods, thereby eliminating the uncertainty of what transfer pricing methods different advisory commissions may apply. As was explained in chapter 5.1.3.1 the Convention does not provide for any specific criteria or method for the advisory commission to follow, other than the arm’s length principle, when giving their opinion.

The cases referred to the ECJ would also give guidance for the taxpayer and the tax authorities, as such cases would be published and serve as precedents. This would greatly reduce the uncertainty MNGs may face when concluding transfer pricing cases.

However, subjecting transfer pricing cases to the ECJ was the very loss of sovereignty that the Member States wished to avoid more or less 15 years ago, when the Convention was signed. It is therefore unlikely that the Member States have changed their view in this short period of time and thus would all agree to such an amendment. This also given the work done to improve the existing Convention.

9.6.2 The creation of a standing arbitration commission

In the author’s opinion another possibility to improve the Convention would be the creation of a standing arbitration commission. The advisory commission procedure under the Convention would thus be revised into a genuine arbitration procedure where transfer pricing experts would be allowed to reach a binding decision for the resolution of the double taxation issue. The arbitration commission would also have the jurisdiction to interpret the Convention and its terms and suggest improvements. Such a standing arbitration commission could for instance be created under the JTPF since it is, as stated, a consultative expert group that is to identify solutions to the practical problems posed by transfer pricing practices in the EU. Thus the standing arbitration commission would have a determined meeting place, language and furthermore, as it would be a standing one, there would be no need for the selection process of the independent persons for each case. As was seen in the Electrolux case, the selection process can be lengthy.

Creating an arbitration commission under the JTPF would also be beneficial as regards the interpretation of the Convention as the JTPF has done considerable work in the field and followed up on the Electrolux case with discussions of the procedure’s efficiency. Thus it would be practical, for transparency reasons, to have the arbitration commission under the very panel that is charged with the objective to analyse and improve the Convention and come up with practical solutions to transfer pricing problems. An issue could of course be that it could prove insufficient with only one arbitration commission
and cases would maybe face waiting periods before they could be referred to the commission. This is, however, no different from the situation with referring cases to the ECJ. Since the main problem would be a waiting period before the referral to the commission, awaiting the conclusion of another case, the waiting period would fall in the period that is unregulated anyway. Once referred to the commission the six month time limit would apply. Furthermore, it should be kept in mind that cases would only be referred to the commission where member states could not reach an agreement during the mutual agreement procedure.

Although this improvement would not provide for the guiding precedents, as the ECJ would, it still would improve the guiding value of possible publications. Since the Convention allows the competent authorities to derogate from the opinion of the advisory commission, a possible published opinion would lose its guiding value where it was not accepted by the competent authorities. As the suggested improvement would make the commission’s decision binding, thus also removing the last six month period where the competent authorities can derogate from the decision, it would guarantee that every published decision was the accepted practice. A revision for turning the advisory commission into a standing arbitration commission could, as explained, be made either under Art. 21 of the Convention or with a separate convention.

This solution would be beneficial compared to having the Convention subjected to the interpretation of the ECJ as the ECJ may not poses the competence and same level of expertise and insight as a panel with elected independent transfer pricing experts. As seen, in chapter 8.1, the JTPF consists of, experts from each Member State and experts from business. The resolutions by an arbitration commission under the JTPF would thus also more likely reflect positions taken by the Member States and business on transfer pricing than the decisions of the ECJ. For these reasons it is also more likely that this improvement is accepted by the Member States than subjecting cases to the jurisdiction of the ECJ.
10 Conclusions

The Arbitration Convention was a clear step away from European Community legislation and thus also a clear step away from putting the well-functioning of the internal market as the highest priority for the Member States. The Member States were not, and are most likely still not, ready to surrender fiscal sovereignty in the field of transfer pricing and thus jeopardise tax revenues in accordance with their own national and international provisions, by giving the ECJ jurisdiction.

The Convention does, however, take the first step to create a resolution for the problematic area of transfer pricing where, as has been seen, enterprises may face double taxation that often may not be resolved. It does solve many of the inefficiencies with other mechanisms for double taxation resolution and it is the first tool for enterprises to ensure that double taxation due to transfer pricing adjustment is eliminated. It is however a forced out step, taken only to avoid a leap with more consistent, uniform and far-reaching obligations that an EC Directive would have imposed. The result is a Convention that seemingly was swiftly put together to present the Commission with an alternative, before it continued a move for a Directive that the Member States, for fiscal sovereignty reasons, wished to avoid. It is a Convention leaving much room for differing interpretation and practical problems. The result is also that the Convention is neither interpreted in a binding way by any organ, that would bind the Member States to one uniform interpretation of the Convention, nor has it a “policing” organ that could take action against any Member State abusing the escape hatches or not applying the Convention in the intended manner.

For this reason the Arbitration Convention has numerous problems regarding interpretation and application. A major disadvantage with the chosen legal form was the lengthy ratification process that not only the Convention, but also the Prolongation Protocol and Accession Convention were subjected to. The fact that the Convention was only given a life span of five years at a time was also a major disadvantage, which the Member States wished to improve by allowing for an automatic extension of the Convention’s life span after each five year period. This Protocol too needed to be ratified which took almost five years. The drafters of the Protocol had most likely predicted this based on the time it took to ratify the Convention in the first place and therefore included a provision to allow the Protocol, and thereby the Convention to take effect from 1 January 2000. This retroactive/provisional effect of the Protocol was intended to ensure a smooth application of the Convention between 1 January 2000 and the date on which the Protocol had been ratified (1 November 2004). However, it was interpreted very differently by the Member States, with some interpreting the Convention as completely suspended, thus only starting the procedures under it once the Protocol had been ratified by all Member States, and others applying the Convention provisionally but not following the stated time limits.

The author holds that the Convention in its entirety should have been applied provisionally, as that would have been most in line with the provision in the Protocol interpreted in accordance with the Vienna Convention and with the intention of the drafters. However, given its vagueness and the lack of an organ that could have clarified the provision in a binding way it is difficult to give any interpretation a higher merit than another. The differing interpretations of the Protocol still may have repercussions today as some States that considered the Convention as suspended earliest will start setting up the ad-
visory commission in November 2006, after the two year mutual agreement procedure, for requests during the interim period. However, the States that applied the Convention provisionally may already have started setting up the advisory commission at the end of 2004. Nevertheless, this clearly shows the need for an organ that interprets the Convention and can advise the Member States for a uniform application. The JTPF was created for precisely this end and has addressed several problematic areas of the Convention, one being the accession of the Member States that entered the EU in 2004.

The Convention has a close relation to the EC but in the author’s view has no supranational status since a close connection to the Community cannot confer a supranational status. It is clear that there was no such intention at the adoption of the Convention, as a supranational act, infringing the Member States’ fiscal sovereignty, was precisely what the drafters of the Convention wished to avoid. The legal basis and involvement of the Commission and Council, was in the author’s opinion, the only choice for the Member States to avoid a supranational act, the Directive, without having their international treaty, the Convention, challenged for its validity as its conclusion could be deemed to violate the competence of the Council and Community loyalty of the Member States. Thus it can be concluded that, as neither the Convention establishes its supranational character nor was there an intention to give it a supranational character, the Convention does not have supranational status. However, in the author’s opinion, it most certainly takes precedence over tax treaties in that it creates a minimum guarantee, a guaranteed mechanism, for taxpayers to have transfer pricing related double taxation eliminated. It derives its precedence over tax treaties from the principle of *lex specialis derogat de lege generali*. Thus only more far reaching obligations take precedence over the Convention.

It is apparent that the wording of the purpose and scope of the Convention does not establish an exclusive application only to transfer pricing cases; rather it establishes the conditions that have to be met in order for it to apply. There are sufficient connections between the conditions that the Convention sets out and the conditions in cases of double taxation due to thin capitalisation provisions for these cases to fall within the purpose and scope of the Convention, and also fall under the arm’s length principle expressed in both the Convention and OECD Model Convention. Even if thin capitalisation is a different area of law, it results in the same conditions that the Convention applies to: Double taxation in connection with adjustment of profits of associated enterprises, profits that for purposes of taxation are included in the profits of an enterprise of a Contracting State and also included in the profits of an enterprise of another Contracting State. This because an enterprise of a Contracting State participates, if nothing else at least, directly in the capital of an enterprise of another Contracting State and conditions are imposed between the two enterprises in their financial relations which differ from those which would be made between independent enterprises. This is true for both thin cap provisions that merely disallow a deduction of interest payments and for thin cap provisions that also recharacterise the interest as dividends. However, the Convention is in accordance with its set out scope only applicable to the additional income tax that the enterprise will face. The dividend tax the enterprise faces, constituting in fact a triple taxation of the very same income; the interest payment, does not fall within the scope of the Convention.

Therefore it can be concluded that the Convention is applicable to double taxation cases due to thin cap provisions in accordance with its wording, as regards the double taxation
The Implications of the Arbitration Convention

with income tax. However, in the author’s opinion, it is in reality for the time being unlikely that the Member States will apply the Convention to these cases. This because the Convention does not apply to cases of double taxation where its terms are interpreted differently, that is the applicability of the Convention can not be interpreted under its own procedures. Therefore where two Member States do not agree on the Convention’s applicability to thin cap cases the Convention is inapplicable.

The applicability to thin cap provisions of the Convention, although clearly in accordance with its wording, therefore in the author’s view needs a clarification, before such cases will be able to be referred to the Convention. Such clarification should come from the JTPF.

The Convention does not specifically state when the time limits of its procedures start. The JTPF has however clarified the uncertainties regarding the start of these time limits under the Convention. The start of the deadline for making a request to invoke the Convention has been clarified to start on the date of the first tax assessment notice or equivalent which results or is likely to result in double taxation. As each Member State’s definition of the specific event has then been included in the Code of conduct this uncertainty is definitely eliminated. The way the taxpayer must present or submit a request to invoke the Convention, thereby starting the two year limit for the mutual agreement procedure has also been clarified in the Code of Conduct, with a list of specific minimum information that the taxpayer must include in the request for the case to be considered as presented/submitted. To the author it would however seem appropriate not to refer to the same action, the presentation of a case within the three year deadline to start the two year mutual agreement procedure, with the two different terms; submitting and presenting. It would for clarity sake be beneficial to revise the wording to include only one of these terms.

The Convention, however, leaves a period completely without time limits in its otherwise completely time limited procedures. The time between the end of the mutual agreement procedure and the start of the six month advisory commission procedure once the case is referred to it, is left unregulated. That is, what amount of time is spent by the competent authorities on setting up the advisory commission, before they refer the case to it, is left to the discretion of the competent authorities with no time limits. This interpretation was chosen in the Electrolux case and can furthermore be concluded from the wording of the Code of Conduct. This is most unfortunate as it puts a hole in the procedures of the Convention, which in practice was, and can be, very lengthy. Thus diminishes one of the possible advantages of the Convention, namely having cases of double taxation resolved swiftly and within a specific period of time. Thus the author believes that it is of great importance that this unregulated period is clarified by an imposed deadline for the setting up of the advisory commission. Such clarification could be done by amending the Convention, but as this would call for ratification by all Member States it could result in a long period where the issue would still be unregulated. A better solution would be that the JTPF would address the issue with a possible Code of Conduct. There are also more practical questions to the advisory commission procedure of the Convention that it leaves open for interpretation, for instance what language to use, where to meet, who initiates the procedure, what the opinion of the commission should include, etc. The Code of Conduct has given guidance for these practical issues and the unregulated period should thereby be shortened.
As the Convention does not apply to cases of double taxation where one of the enterprises concerned is liable to a serious penalty, it confers the possible double taxation as an additional penalty for such enterprise. The main concern with this provision is that it refers to the domestic law of each Member State for the definition of what constitutes a serious penalty in that Member State and thus there are differences in what is considered to constitute a serious penalty. The significant divergence of interpretation leads to unequal treatment of enterprises as some are penalised only for dolus and others also for culpa. Furthermore, to subject the enterprise to further penalty by not allowing it to have access to the Convention, when it already has received what is considered a fair penalty in the Member State, is to the author, legally unjust. Especially if such penalty results in the inability to eliminate double taxation, as then the enterprise is being punished more severely than an enterprise that has been subjected to the same penalty for a similar action but not due to international trade. To consider is also that a double taxation potentially could result in a higher amount of lost profits than the actual penalty. This potential unjust treatment of an enterprise leads the author to the conclusion that the serious penalty exclusion should be removed.

Another provision in the Convention that would need clarification is the criteria of a complaint being well-founded for the competent authorities to be obligated to start the procedure under the Convention. The author interprets this criteria to refer to the other criteria set up in the very same article for the presentation of a case. However, as the criteria is vague it allows for different interpretation and given that there is no organ to ensure the uniform interpretation of the Convention this provision can potentially result in that the determination of whether a case is considered well-founded is left to the discretion of the competent authorities.

Even though the Convention has uncertainties, it does pose a great improvement over the mutual agreement procedure under double taxation treaties. The main improvement is that the Convention does in fact guarantee a resolution of the double taxation, which the tax treaties modelled on the OECD Model Convention do not. It furthermore sets out a time limit on the procedure and even though it leaves an unregulated period, the mutual agreement procedure under it has a maximum two year limit and many cases are likely to be resolved already during that first phase. Furthermore, the unregulated period is likely to be of less concern with the guidance provided by the Code of conduct for the proceedings for setting up a advisory commission during that period. The procedure under the Convention also allows the taxpayer participate in the advisory commission procedure thus allowing him to present his point of view. This is an advantage compared to the mutual agreement procedure the OECD Model Convention provides for, as the taxpayer is not indifferent to how double taxation is resolved since there is a difference for an MNG where the profits are allocated.

Since APAs are not yet a well developed mechanism within the EU to resolve double taxation and the fact that they constitute a mechanism to avoid double taxation disputes arising in the first place rather than a mechanism to deal with a double taxation that is at hand, they can only be used as a supplement to other mechanisms for the resolution of double taxation. APAs are also unlikely to be able to be concluded for all MNG’s intra-group transactions and it is therefore obvious that mechanisms dealing with transfer pricing related double taxation once a transaction has been adjusted are not only needed but also constitute the general resolution mechanism.
Thus the efficiency of the Convention is of great importance as it poses the only EC-wide mechanism that deals with the concrete resolution of transfer pricing related double taxation disputes and also guarantees the resolution of such disputes. It is thus necessary to clarify the analysed uncertainties of the Convention as they relate to the efficiency and function of the Convention.

One way of improving the Convention would be to allow the advisory commission to become a genuine arbitration procedure where transfer pricing experts would be allowed not only to reach a binding decision for the resolution of the double taxation issue but also to interpret the Convention and suggest improvements. The ability to interpret the terms under the Convention would eliminate the possibility of the Convention being inapplicable to cases where the Member States interpret its terms differently. This panel should also be a standing one with an agreed meeting place and language. This solution would be beneficial compared to having the Convention subjected to the interpretation of the ECJ as the ECJ may not possess the competence and same level of expertise as a panel with elected independent transfer pricing experts. Such a panel could be created under the JTPF. The advantage of subjecting the Convention and cases referred to it to the ECJ would of course be that it would ensure a uniform application of the Convention and would also deliver published precedents to guide the tax authorities and the enterprises. However, it seems unlikely to the author that the Member States would agree to subject the Convention to interpretation of the ECJ as this was what they wished to avoid 15 years ago and it is unlikely that this opinion has changed. Although it could come down to a consideration where the States would weigh the disadvantages of surrendering sovereignty compared with the benefits of having the problematic issues of the Convention resolved.

In the concluding view of the author, the best solution for improving this first tottering step towards a guaranteed resolution of transfer pricing double taxation, would be to extend the jurisdiction of the advisory commission into a genuine arbitration commission with the ability not only to definitely settle double taxation disputes but also to interpret the Convention.
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