

# Tax Analysis

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## BEPS Action 14: Make Dispute Resolution Mechanisms More Effective

The Organization for Economic Cooperation and Development on 18 December 2014, released a public discussion draft pursuant to Action 14, "Make Dispute Resolution Mechanisms More Effective," of the Action Plan on Base Erosion and Profit Shifting. The Action Plan recognizes that the actions to counter BEPS must be complemented with actions that ensure certainty and predictability for businesses, and Action 14 -- "Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under [the mutual agreement procedure] MAP, including the absence of arbitration provisions in most treaties and that fact that access to MAP and arbitration may be denied in certain cases" -- an important component of this recognition, should be readily welcomed by taxpayers in the new uncertain BEPS world.

The discussion draft includes the preliminary results of the work carried out pursuant to Action 14 to identify the obstacles that prevent countries from resolving disputes under the MAP and to develop possible measures to address these obstacles. According to the discussion draft, it must be read in the broader context of the intention to introduce a three-pronged approach designed to represent a step change in the resolution of treaty-related disputes through the MAP. This three-pronged approach would (i) consist in political commitments to effectively eliminate taxation not in accordance with the OECD Model Tax Convention on Income and on Capital (such political commitments reflecting the political dimension of the BEPS project), (ii) provide new measures to improve access to the MAP and improved procedures (this discussion draft describes the envisaged measures) and (iii) establish a monitoring mechanism to check the proper implementation of the political commitment.

This three-pronged approach is intended first to take advantage of "political commitments" (by referencing the BEPS project) to encourage governments to make the recommended policy decisions and then to encourage governments to take specific measures to address potential obstacles. The third prong is an after-the-fact monitoring mechanism to ensure that the political commitments are achieved.

Importantly, the views and proposals included in the discussion draft do not represent the consensus views of either the Committee on Fiscal Affairs or its subsidiary bodies, but rather are intended to provide stakeholders with substantive proposals for analysis and comment. The discussion draft states that not all countries associated with the OECD/G20 BEPS project agree that mandatory and binding arbitration is an appropriate tool to resolve issues that prevent competent authority agreement in a MAP case.

## Guiding Principles

The discussion draft states that the work on Action 14 is expected to result in a political commitment to substantially improve the MAP process through the adoption of specific measures intended to address the obstacles that currently prevent the resolution of treaty-related disputes. The political commitment and the measures through which it will be implemented will be guided by the following four principles:

1. Ensuring that treaty obligations related to the mutual agreement procedure are fully implemented in good faith;
2. Ensuring that administrative processes promote the prevention and resolution of treaty-related disputes;
3. Ensuring that taxpayers can access the mutual agreement procedure when eligible; and
4. Ensuring that cases are resolved once they are in the mutual agreement procedure.

For each of these principles, the discussion draft identifies obstacles to the resolution of treaty-related disputes through the MAP mechanism and presents options to address these obstacles.

### ***Ensuring that Treaty Obligations related to the Mutual Agreement Procedure are Fully Implemented in Good Faith***

The discussion draft identifies two obstacles that may prevent the full implementation of Article 25 of the OECD model treaty.

First, the discussion draft notes that, although paragraph 2 of Article 25 provides that competent authorities “shall endeavor” to resolve a MAP case by mutual agreement, it has been argued that the absence of an “obligation” to resolve a MAP case is itself an obstacle to the resolution of disputes. The discussion draft therefore suggests that language could be added to OECD Commentary on Article 25 that states that “the undertaking to resolve by mutual agreement cases of taxation not in accordance with the Convention is an integral part of the obligations assumed by a Contracting State in entering into a tax treaty and must be performed in good faith,” and that “the competent authorities are obliged to seek to resolve the case in a principled, fair and objective manner, on its merits, in accordance with the terms of the Convention and applicable principles of international law.”

Second, the discussion draft notes that some countries take the position that, in the absence of paragraph 2 of Article 25, they are not obligated to make corresponding adjustments or to grant access to the MAP with respect to the economic double taxation that may otherwise result from a primary transfer pricing adjustment by a treaty partner. The discussion draft offers a seemingly simple solution to address this issue by ensuring that paragraph 2 of Article 9 is included in tax treaties, using the multilateral instrument envisaged by Action 15, when appropriate.

### ***Ensuring that Administrative Processes Promote the Prevention and Resolution of Treaty-Related Disputes***

The discussion draft recognizes that appropriate tax administration practices are important to ensure an environment in which competent authorities are able to fully and effectively carry out their mandate. Various obstacles can stand in the way of the effectiveness of the MAP process, including the lack of independence of the competent authority from a tax administration’s audit or examination function, insufficient resources (lack of personnel, funding, training, etc.) or when the competent authority is evaluated based on inappropriate performance indicators. Further, competent authorities may not employ their authority under Article 25(3) to preempt potential disputes by reaching mutual agreement on matters of a general nature involving treaty interpretation or applications, countries may not have implemented bilateral advance pricing agreement (APA) programs, or countries may fail to consider the implications of a taxpayer’s MAP or APA case for other tax years.

The discussion draft recognizes that field auditors in some countries may seek to influence taxpayers not to utilize their right to initiate the mutual agreement procedure, for example, by entering into a settlement with the taxpayer under which the tax authorities will agree not to apply penalties in return for the taxpayer’s waiver of its right to seek MAP assistance, or by entering into a settlement with the taxpayer under which the tax authorities will agree to a lower audit adjustment in return for the taxpayer’s waiver of its right to seek MAP assistance. In the authors’ experience, options such as these are presented to taxpayers all too frequently during audits.

The OECD is working in parallel with the Forum on Tax Administration’s MAP Forum (the FTA MAP Forum)<sup>1</sup> on administrative procedures that promote the prevention and resolution of treaty-related disputes. The FTA MAP Forum has recognized that audit programs not aligned with international norms with respect to either principle or procedure may significantly hinder the functioning of mutual agreement procedures. Audit practices are therefore a strategic focus of the FTA MAP Forum. The discussion draft notes that the results of the work on Action 14 and the work of the FTA MAP Forum will be complementary and mutually reinforcing.

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<sup>1</sup> See the “Multilateral Strategic Plan on Mutual Agreement Procedures: A Vision for Continuous MAP Improvement” at: <http://www.oecd.org/site/ctpfta/map-strategic-plan.pdf>

The discussion draft presents a number of options to attempt to overcome the obstacles described. The majority of these options propose that participating countries commit to adopt certain best practices contained in the OECD Manual on Effective Mutual Agreement Procedures.<sup>2</sup> The discussion draft also provides the option that participating countries could commit to implement bilateral APA programs, and the implementation of procedures to permit taxpayer requests for MAP assistance with respect to recurring issues and the rollback of APAs. The authors welcome the options presented by the discussion draft, but recognize the inherent difficulty in getting countries to effect real changes to overcome many of these obstacles.

### ***Ensuring that Taxpayers Can Access the Mutual Agreement Procedure When Eligible***

The discussion draft delineates eight potential obstacles that may prevent taxpayers from appropriately accessing the MAP or place an undue burden on taxpayers seeking MAP. The obstacles include complexity and lack of transparency of the procedures to access and use the MAP, excessive or unduly onerous documentation requirements to request the MAP, unclear access to MAP when domestic or treaty-based anti-abuse rules have been applied, cases in which a competent authority unilaterally considers that a taxpayer's objection is not justified, the interaction between domestic law remedies and the MAP, the potential financial issues associated with the requirement that the disputed tax be paid to access the MAP, time limits to access the MAP, and issues related to self-initiated foreign adjustments.

The discussion draft presents a number of options to attempt to overcome the obstacles described. These include:

- A commitment by countries to develop and publicize rules, guidelines, and procedures for the use of the MAP, and to identify the office that has been delegated the responsibility to carry out the competent authority function (along with contact details).
- A commitment by countries to identify the specific information and documentation that a country is required to submit with a request for MAP assistance, seeking to balance the burdens involved in supplying such information.
- Clarify the availability of MAP access when an anti-abuse provision is applied.
- A commitment by countries to a bilateral notification and/or consultation process when the competent authority to which a MAP case is presented does not consider the taxpayer's objection to be justified.
- Clarify the meaning of "if the taxpayer's objection appears to be justified" in the Commentary on Article 25.
- Amend Article 25(1) to permit a request for MAP assistance to be made to the competent authority of either contracting state.
- A commitment by participating countries to clarify the relationship between the MAP and domestic law remedies, including the publication of clear guidance on the relationships between the MAP and domestic law remedies.
- Clarify issues connected with the collection of taxes and the mutual agreement procedure, including potentially changing the commentary on Article 25 to address the suspension of collection procedures pending resolution of a MAP case.
- Clarify issues connected with time limits to address the mutual agreement procedure, including in their treaties the second sentence of paragraph 2 of Article 25 ("Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States").
- Changes to the commentaries on Articles 7, 9, and 25 to clarify the circumstances when double taxation could be resolved under the MAP in the case of self-initiated foreign adjustments.

### ***Ensuring that Cases are Resolved Once They Are in the Mutual Agreement Procedure***

The discussion draft notes that some of the main obstacles to the resolution of treaty-related disputes through MAP are issues related to MAP processes, including lack of a principled approach to the resolution of MAP cases; lack of cooperation, transparency, or good competent authority working relationships; absence of a mechanism, such as MAP arbitration, to ensure the resolution of all MAP cases; issues related to multilateral MAPs and APAs; and issues related to consideration of interest and penalties in the MAP.

These obstacles are likely to become more prevalent as a result of the work on BEPS and the potential introduction of new tax treaty and transfer pricing rules.

The discussion draft explores various options to assist with overcoming these obstacles. Many of these center around adopting the relevant best practices currently included in the OECD Manual on Effective Mutual Agreement Procedures. The discussion draft also discusses the main policy and practical issues connected with MAP arbitration and options to address them. It is clear from reading the discussion draft that not all OECD countries intend to adopt mandatory

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<sup>2</sup> Available at: <http://www.oecd.org/ctp/38061910.pdf>

binding MAP arbitration, and the options included attempt to address this by proposing that countries consider tailoring the scope of MAP arbitration to encourage countries to adopt a MAP arbitration provision with a limited scope rather than no provision at all, and the potential amendment of Article 25(5) to permit the deferral of MAP arbitration in appropriate circumstances. The discussion draft also requests specific comments on the preferred default form of decision-making in MAP arbitration (for instance, the independent opinion approach or baseball arbitration).

One of the long-standing key issues affecting taxpayers is the need for effective mechanisms to resolve multijurisdictional international tax disputes. While the discussion draft acknowledges the issue in light of the substantial increase in the pace of globalization and identifies situations in which multilateral situations can occur, the discussion draft does not fully develop options to address these issues. The discussion draft provides three examples of such multilateral situations: (i) triangular cases (when an enterprise of State A transfers goods or services through its permanent establishment situated in State B to an associated enterprise situated in State C, and an adjustment to the transfer pricing of the transfer is made by the tax administration of State B); (ii) situations in which an adjustment in one state results in cascading adjustments in other states; and (iii) situations in which an entity that is a member of an MNE group performs certain functions for the benefit of a number of associated enterprises and different transfer pricing adjustments are made to the resulting charges in the various states of residence of these associated enterprises. The discussion draft also requests that commentators provide other examples of multilateral situations that raise issues for the MAP.

### Mainland China Practice and Observation

Based on our observation, the State Administration of Taxation (SAT) has been paying much attention to the MAP cases in recent years, which has achieved a certain degree of achievements helping many MNCs to resolve the double taxation issues. In the meantime, in practice the SAT has been putting more resources to develop a specialist team with improved capability to handle the increasingly complicated MAP cases.

China has entered into numerous tax treaties with most major countries/regions globally and therefore in theory most cross-border tax disputes can be resolved by MAP embedded in treaties. However, it is unclear at this point what the SAT's view on options to address the various MAP obstacles is going to be. In addition, it can be expected that the more detailed views and opinions of the SAT will be provided in the upcoming revisions to Guoshuifa [2009] No. 2.

### Conclusion

The discussion draft in its opening remarks makes clear the OECD's observation that international tax and transfer pricing controversy has increased, and we infer its expectation that in the uncertain BEPS world, tax related controversy will continue to rise around the world. The discussion draft also appropriately notes that Action 14 represents a unique opportunity to remedy the existing cumbersome MAP, plagued with impediments and inefficiencies, on a broad, rather than treaty-by-treaty scale.

In light of this, the discussion draft on BEPS Action 14 should be welcome reading for taxpayers. As noted at the outset, the discussion draft states that it should be read in the broader context of the intention of the OECD to introduce a three-pronged approach designed to represent a step change in the resolution of treaty-related disputes through the MAP. The OECD expects that the work on Action 14 will result in a political commitment to substantially improve the MAP process through the adoption of specific measures intended to address the obstacles that currently prevent the resolution of treaty-based disputes, guided by the four principles described above.

The OECD has invited interested parties to submit comments on the discussion draft by 16 January 2015, and comments received will be made available to the public.

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