



ECOFIN agrees on new directive on tax dispute resolution mechanisms

Global Transfer Pricing Alert 2017-022

The European Council of Finance Ministers (ECOFIN) on 23 May agreed to the terms of a proposed new council directive on tax dispute resolution mechanisms in the European Union. The directive aims to improve existing mechanisms for resolving tax disputes between EU member states arising from the interpretation of double tax agreements by improving access to and the effectiveness of mutual agreement procedures (MAP) and establishing procedures for dispute resolution by arbitration.

Scope of the directive

The directive establishes rules to resolve double taxation disputes that arise from the interpretation and application of double tax treaties and EU conventions between EU member states. Double taxation includes an additional tax charge, and increase in tax liabilities or a reduction of losses that could be used to offset taxable profits.

Member states have the ability to deny access to the arbitration provisions of the directive, on a case-by-case basis, when the dispute does not involve double taxation. Cases also may be denied access when penalties are incurred for fraud, wilful default, or gross negligence. Domestic proceedings (e.g., judicial processes) may continue simultaneously.

Improvements to MAP

Businesses and individuals can initiate the mutual agreement process by submitting a complaint on a question of dispute to each of the competent authorities of the member states concerned. An administrative simplification is available for individuals and smaller undertakings. The complaint must be made within three years from the receipt of the first notification of the action resulting in the question of dispute. In a UK transfer pricing context, this would be the date of issue of a notice, letter, or amendment on the finalization of an enquiry that gives rise to double taxation.

The complaint must provide details of the relevant facts and circumstances of the case, the nature and date of the actions giving rise to the question in dispute, and an explanation of why the business or individual considers that there is a question in dispute. The competent authorities can request additional information within three months from the date of receipt of the complaint, and this should be provided within three months. The competent authorities are required to accept or reject the complaint within six months of receiving the information.

There are limited grounds for rejecting a complaint: there is no question in dispute, the complaint was not timely, or the required information has not been provided correctly. The business or individual is entitled to appeal a rejection, and the process for doing so is determined by whether one or all competent authorities reject the complaint.

Competent authorities must endeavor to resolve the dispute by mutual agreement within two years of acceptance (extendable to three years). Once a resolution is agreed upon, the decision is binding regardless of any domestic time limits, subject to acceptance by the business or individual.

Dispute resolution by mandatory binding arbitration

When the competent authorities fail to resolve the question in dispute by mutual agreement within the time frame provided, the business or individual has 50 days to request that arbitration procedures commence. An advisory commission will be set up within 120 days, and it must deliver its opinion on how to resolve the dispute within six months (extendable by three months if necessary). Businesses or individuals may appear before the advisory commission at their request, and must appear if required by the commission.

The advisory commission will consider the evidence provided, the provisions of the applicable double tax treaty, and the domestic law of the member states concerned, and adopt an opinion by simple majority. The competent authorities have an additional six months to adopt a final decision. This can differ from the advisory commission's opinion, but if the competent authorities fail to reach an agreement they will be bound by the advisory commission's opinion. Subject to the business or individual accepting the final decision, the final decision is binding and will be implemented regardless of time limits in domestic tax legislation.

The final decision will not create precedent. Every decision will be published (either in full or, at the request of the business, individual, or competent authorities, in an anonymized,

summarized form) and will be made publicly available by the European Commission.

An advisory commission will be comprise of a chair, up to two representatives of each competent authority, and up to two “persons of independent standing” appointed by each competent authority.

There are criteria for selecting independent members, including that they should not be employees of tax authorities, nor have given tax advice on a professional basis for at least three years (five years in relation to the business, individual, or tax authorities concerned) and must offer a sufficient guarantee of objectivity. The chair, typically a judge, will be elected by the other members of the advisory commission from a collective list of suitable persons nominated by each EU member state. In most cases, the costs of the advisory commission will be borne by the member states involved.

Choice of arbitration process

Any other type of dispute resolution process is also acceptable, including the “final offer” (otherwise known as “last best offer” or “baseball”) arbitration process, whereby each competent authority presents their final offer, with reasons, and the advisory commission chooses one outcome from the two presented. Alternatively, competent authorities may establish an Alternative Dispute Resolution Commission, with more flexibility in its composition but subject to the same timetable and independence rules.

Next steps and timetable

The directive will be adopted by ECOFIN later in 2017 (once the European Parliament has issued an opinion). Member states are to adopt the directive in their domestic legislation by 30 June 2019. ECOFIN will review the operation of the directive in 2024.

The directive will apply to complaints submitted after 1 July 2019 relating to tax years starting on or after 1 January 2018. Competent authorities may agree to apply the directive to complaints submitted earlier and/or for earlier tax years. Application of the directive in the UK will depend on the UK’s agreements with the European Union at that time.

Comments

Effective resolution of disputes that could lead to double taxation remains an essential objective of double tax treaties and is key to removing one of the barriers to international trade. The number of disputes between tax authorities globally continues to rise. There are substantial improvements in the directive compared to the current EU Arbitration Convention, which applies only to transfer pricing disputes and the attribution of profits to permanent establishments.

The directive will apply to all instances of double taxation under double tax treaties and the timelines for settlement will be enforced.

The key benefit of a binding arbitration process is the persuasive effect it has on competent authorities' ability to reach agreement under the MAP, without the need to resort to arbitration. It is expected that relatively few cases will go to arbitration. The option of 'baseball arbitration' using final offers from competent authorities is helpful, and if selected could result in swifter resolution and reduced arbitration costs.

There are some weaknesses in how the arbitration process has been defined, including having representatives of each competent authority on the arbitration panel. Allowing businesses to request to appear before the arbitration panel and also to choose whether to accept the arbitration decision may be welcome by some, but could delay the process and may be a barrier to the finality of the arbitration. It also would be preferable if any domestic proceedings were suspended during the arbitration. The directive contains safeguards regarding confidential business information. Some businesses may have concerns about the publishing of decisions (although the decisions will be anonymized and in summarized upon request). Publishing decisions is a mixed benefit, because they will be of limited precedent value and will add more time to the process.

The directive applies to disputes between EU member states, and it is essential that countries are not deterred from adopting the broader mandatory binding arbitration clauses in the G20/OECD's Multilateral Convention, which may have potentially broader effect and more benefits.

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