

## BEPS Action 14: Make dispute resolution mechanisms more effective

On 18 December 2014 the OECD, as part of its work on the Action Plan to address Base Erosion and Profit Shifting ('BEPS'), released a Discussion Draft on Action 14 to make dispute resolution mechanisms more effective. This Action is focussed on addressing obstacles that prevent countries from solving treaty-related disputes under the mutual agreement procedure ('MAP') provided by Article 25 of the OECD Model Tax Treaty. A taxpayer may make a MAP claim where there has been taxation that is 'not in accordance with' the terms of a specific double tax treaty. Cases related to transfer pricing (Article 9), permanent establishment (Article 5) and business profits (Article 7) are most commonly encountered.

As with other Discussion Drafts on BEPS Actions, the views and proposals do not represent a consensus view from the G20/OECD governments involved but rather are intended to provide stakeholders with substantive proposals for public analysis and comment. In particular, the Discussion Draft notes that not all governments (notably and publically China and India) agree that mandatory and binding arbitration is an appropriate tool to resolve issues under MAP.

### Deloitte Comments and Business Next Steps

Effective resolution of disputes that could lead to double taxation remains an essential objective of double tax treaties, key to removing one of the barriers to international trade. The length of the Discussion Draft and the number of options proposed illustrate the many problems that arise in practice. Developments in other areas of the BEPS project, including on permanent establishments, transfer pricing and treaty anti-abuse are likely to increase the number of disputes, at least in the short term, as businesses and tax authorities adjust to new rules. In addition, specific changes such as the likely increase in the use of profit splits will increase the multi-jurisdictional nature of disputes. Resourcing of competent authority functions will be a key issue for tax authorities, and the proposed monitoring of implementation and practice of MAP will be an important development to ensure its success.

Mandatory binding arbitration remains the best (perhaps only) option for ensuring resolution of cross-border issues and the avoidance of double taxation. The option for use of so-called 'baseball arbitration' using final offers from tax authorities is encouraging, and may serve to give swifter resolution and reduce arbitration costs.

### Approach to improving treaty-related disputes under MAP

The Discussion Draft sets out the intention to introduce a 'three-pronged approach' to improving MAP resolution of disputes. These include (i) **political commitments** to ensure that tax is levied in accordance with treaties and that double taxation is effectively relieved; (ii) **new measures** to improve access to MAP and improved procedures; and (iii) a **monitoring mechanism** to check on proper implementation. The Discussion Draft deals with item (ii).

The work on Action 14 will address specific obstacles that prevent the resolution of disputes by reference to four principles and will set out a **minimum standard** to which countries will commit. In addition, there will be other measures, including binding arbitration, that countries may choose to adopt to address MAP issues comprehensively.

#### 1. Ensuring that treaty obligations related to MAP are fully implemented in good faith

The Discussion Draft proposes guidance in the Commentary to the OECD model treaty to emphasise a country's obligations to

find a resolution under MAP.

Some bilateral treaties do not include the OECD model text in relation to transfer pricing and in particular do not explicitly refer to 'corresponding adjustments' where there are transfer pricing adjustments made in another country. Some countries take the view that this means they are not obliged to make such corresponding adjustments, nor grant access to MAP. The Discussion Draft proposes reference to **corresponding adjustments** be included in all treaties, using the **multilateral instrument** envisaged by Action 15.

## 2. Ensuring that administrative processes promote the prevention and resolution of treaty disputes

This work will be coordinated with the parallel project being undertaken by the OECD's Forum on Tax Administration's MAP Forum. The Discussion Draft proposes that countries adopt the **best practices** currently included in the OECD's *Manual on Effective Mutual Agreement Procedures* including ensuring the **independence** of competent authorities from tax authority auditors, the key issue of providing sufficient **resources** (personnel, funding, training etc.), and using appropriate **performance indicators** for competent authorities.

The Discussion Draft also proposes that countries commit to implementing bilateral **advance pricing arrangements** ('APA') programmes and procedures for resolution of multi-year issues (such as the 'roll back' of agreements where the facts are the same). It is proposed that countries that persist with allowing tax authorities to conclude audit settlements which **preclude access to MAP** will be asked to either discontinue the practice or provide for spontaneous notification of the competent authorities of both countries.

Competent authorities are authorised to resolve by mutual agreement any difficulties arising from **interpretation** of the treaty. The Discussion Draft proposes that countries commit to publishing agreements reached on general interpretation to assist with the prevention of future disputes, and to commit to adopting best practices to alleviate double taxation generally, even where not specifically provided for in the treaty.

## 3. Ensuring that taxpayers can access the MAP when eligible

The Discussion Draft suggests participating countries commit to best practices in relation to **reducing complexity** and lack of transparency in relation to access to MAP, including unduly onerous documentation requirements.

A difficult area is the uncertainty of the operation of MAP where domestic and/or treaty-based anti-abuse laws apply. The Discussion Draft notes that practice varies from country to country. Such uncertainties are expected to increase with the introduction of the principal purposes test under BEPS Action 6 on preventing treaty abuse. The Discussion Draft proposes that countries commit to providing **access to MAP even in cases involving anti-abuse** rules. Alternatively, it suggests that countries notify treaty partners of circumstances where access to MAP is denied.

One country may refuse a MAP request, but the other country concerned might have come to a different conclusion. Options are proposed to widen access to MAP: requiring countries to clarify access conditions, allowing taxpayer requests to be made to either competent authority, or committing to a **bilateral notification/consultation process** to ensure that refusals are evaluated by both authorities.

There may be uncertainty over the priority of use of MAP or resolution through domestic courts, and countries take different views on precedence. The Discussion Draft proposes that countries commit to publishing guidance on the interaction between MAP and domestic law processes, and that **priority should be given to MAP** by including provisions for the suspension of domestic law proceedings.

The Discussion Draft recommends the introduction of best practices in relation to time limits to access MAP and considers the cash flow implications of the double taxation suffered by a taxpayer during the MAP process. The OECD will consider potential suspension of the collection of tax during the MAP process, where a similar suspension would be available under a domestic

law process.

An important issue arises in relation to uncertainty around **'self-initiated' adjustments** (eg. under corporation tax self-assessment). Some countries take the view that this is not an 'action' by a country and therefore deny access to MAP. The OECD proposes to clarify the commentary to make clear the obligations to address double taxation in such cases.

#### 4. Ensuring that cases are resolved once they are in the mutual agreement procedure

Countries are encouraged to adopt best practices, including **fair and objective MAP negotiations**, good faith application of the treaty, and resolution of each MAP case on its merits. The Discussion Draft suggests that competent authorities could agree when it might be appropriate for taxpayers (generally excluded from involvement in the negotiations between tax authorities) to make presentations to clarify and ensure a shared understanding of the facts. The Discussion Draft proposes changes to the commentary to make clear that interest and penalties should be treated in the same manner as the underlying tax that is subject to MAP.

The key issue remains that of **mandatory binding arbitration** to ensure effective resolution and mitigation of double taxation. Despite being introduced into the OECD model in 2008, the Discussion Draft notes that adoption has not been as broad as expected. Whilst extending the coverage of binding arbitration remains the OECD's objective (and it expects policies to evolve over time as countries gain experience and familiarity with MAP arbitration), several options are proposed in the absence of political commitment from all countries. One option is that countries with reservations on the use of binding arbitration may limit its scope, perhaps to certain articles of the treaty, or to exclude cases involving treaty or domestic anti-abuse rules.

The Discussion Draft requests input on two options for decision-making under arbitration, including the conventional **'independent opinion' approach** based on the evidence presented and resulting in a written opinion from the arbitrator, and also the **'final offer' (also known as 'baseball arbitration') approach**. Under this approach, each competent authority would present their final offer for resolution, with reasons, and the arbitrator's role would be to choose one outcome from the two presented. Further proposals look at setting minimum qualifications for arbitrators and increasing confidentiality requirements, including in relation to taxpayers whilst their cases are in arbitration.

The Discussion Draft suggests development of a specific provision to address MAP in relation to multi-jurisdictional issues, and offers that the multilateral instrument envisaged under BEPS Action 15 may facilitate this.

#### Timetable

Comments are invited by 16 January 2015 – an especially short timeframe. A public consultation meeting on Action 14 will be held by the OECD in Paris on 23 January 2015. Registration details are available on the OECD website.

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