International tax dispute resolution – the MLI conundrum

Peter Nias, barrister and Centre of Effective Dispute Resolution (CEDR) panel mediator of Pump Court Tax Chambers in the UK considers whether the arbitration provisions in the OECD’s multilateral instrument (MLI) and Action 14 proposals offer the only option for dispute resolution for all parties.

When the OECD announced its BEPS project some four years ago it included the need to improve the dispute resolution process (Action 14) to show multinational enterprises that there is an effective and efficient mechanism procedure in place to resolve such disputes and in that way win the support of the business community to the BEPS changes.

By the time that the 15-point action plan was published in October 2015, mutual agreement procedure (MAP) disputes had more than doubled over a seven-year period and at the end of 2014 in excess of €11 billion ($13 billion) tax was in dispute between the EU countries alone.

The 2015 BEPS report on Action 14 recognised the need to strengthen the effectiveness and efficiency of the double tax treaty MAP process by minimising the risks and uncertainty and “unintended” double taxation with a requirement for the effective and timely resolution of disputes and the political commitment to doing so.

It proposed a minimum standard comprising some 17 measures with 11 recommended best practices and a peer-based monitoring mechanism overseen by the Forum on Tax Administration (FTA) MAP Forum (whose terms of reference and assessment methodology were published in October 2016) to monitor how countries complied with their obligations to meet that minimum standard.

However, from the outset of the BEPS project there was an ambition to introduce universal mandatory binding arbitration into the MAP process as the panacea to dispute resolution and for such provisions to be included in the multilateral instrument (MLI) introducing other BEPS proposals into the bilateral treaty network between OECD member states.

In the event, only 20 countries expressed an interest in the principle of mandatory binding arbitration, although those countries were at the time involved in more than 90% of outstanding MAP cases reported to the OECD.

The MLI was published earlier in 2017 with 70 countries committing themselves as parties to it in Paris on June 7. Instruments of ratification acceptance or approval must now be deposited before the MLI and all its measures can enter into force.

However, in signing up to the instrument, each country is able to list any reservations it has and many such reservations are now appearing in respect of the arbitration provisions. In fact, one of the original supporting countries has decided at this point not to endorse any of the arbitration provisions.

Whilst the arbitration template set out in the MLI is to be welcomed and indeed is a significant improvement on what it seeks to replace (e.g. there is a default mechanism), the concern is that when the totality of all the reservations are measured against the single ambition to have an effective and efficient mechanism procedure to resolve cross-border tax disputes, multinational enterprises in particular will still have concerns.

What can be done to improve the position?

In 2004, the OECD first recognised the need to improve the process for resolving international tax disputes and produced a report that was followed in February 2007 by further recommendations and the publication of a ‘Manual on Effective Mutual Agreement Procedures’ (MEMAP).

In the 2007 report (at paragraph 16), the OECD committed to developing a proposal for examining the feasibility of implementing the mandatory submission (not mandatory resolution) of unresolved MAP cases to a form of supplementary dispute resolution (SDR) mechanism which would include:

- An evaluation of the various forms of SDR and the situations to which they would be suitable;
- The time frame or “triggering” device that would result in the required submission of the unresolved issue to SDR;
- The role of the taxpayer in the SDR process including the agreement to the submission and the circumstances in which the taxpayer could be denied access to SDR;
- The direct participation of the taxpayer and the SDR process;
- The relation between the SDR process and the taxpayer’s domestic law remedies;
- The relation between the SDR decision and the MAP process generally;
- The form and publication of the SDR decision; and
- The operational and procedural details for carrying out the SDR process.

In that manual, there was a short section (paragraph 3.5.2) noting the beneficial use that could be made of mediation (as a form of SDR) where the use of a mediator or facilitator “could help provide a perspective on the discussions, identify process hindrances, and in some cases bring more of a problem-solving focus to discussions”. In 2008, those recommendations were recognised in
changes to the OECD Commentary on Article 25 introducing in paragraphs 86 and 87 two SDR mechanisms: the use of mediation and expert determination.

As an administrative law matter, SDR can therefore legitimately already be used by those countries that adopt the OECD Model Tax Convention.

However, little more was done. The OECD did not commission any further work from its working party and no country has yet used SDR mechanisms internationally, possibly for the reason that they are little understood and there is no international organisation with the skills and experience to offer the guidance and support necessary to facilitate their use.

More recently, the UN tax sub-committee identified the benefits of non-binding forms of dispute resolution (NBDR) recognising the significant benefits that could arise to both parties from their use, and noting that the use of an independent third person (i.e. a mediator or facilitator) would help the parties formulate their respective positions more rationally and objectively. NBDR should enhance the chance of an agreement and give parties added comfort because they can preserve control over the outcome of the dispute as well as, in some cases, “levelling the playing field”, thus allowing them to gain experience and confidence in international dispute resolution decreasing the effect of “inequality of arms”.

However, that report also recognised the current lack of experience in using NBDR to assist competent authorities in meeting their mutual agreement procedure responsibilities. As such, it recommended drawing up a handbook on dispute resolution and producing a sample NBDR agreement for use by the parties as a tool in complementing MAP – not necessarily as an alternative to it, but possibly as a precursory step where negotiations had stalled.

Could SDR and NBDR mechanisms assist?
The Action 14 minimum standard measures and best practices coupled with the performance monitoring and peer group pressure, together with the MLI arbitration proposal, will certainly improve the position and go some way to redress the ‘dysfunctional behaviour’ on the part of some tax administrations recognised in the BEPS Action 14 final report (paragraph 47).

However, what is missing is a holistic approach to dispute resolution that starts long before any formal MAP engagement is initiated, either by the relevant tax administration or the taxpayer caught up in the dispute for whom that uncertainty has a potentially significant impact on its financial reporting position.

In its strategic plan (see here: www.oecd.org/site/ctpfta/map-strategic-plan.pdf), the FTA Map Forum identified a number of specific initiatives that addressed particular challenges faced by competent authorities with respect to resources, empowerment, relationships and posture, process improvements, the relationship with the audit function and responsibility and accountability.

In summary, it offered a whole series of initiatives that, through training and education, could assist countries with process improvements.

In that respect, the FTA MAP Forum said it would also discuss ways to enhance and streamline the taxpayer’s involvement in case resolution and identify ways to modify and enhance processes in order to anticipate and resolve in advance potential instances of double taxation or taxation otherwise not in accordance with the applicable tax convention.

All this could be brought together in a collaborative dispute resolution (CDR) programme that could include as one of the process tools the use of SDR/NBDR mechanisms.

What is SDR and its benefits?
Supplementary dispute resolution (SDR) procedures (known in the UK as alternative dispute resolution or ADR) were introduced in the UK six years ago to assist in tax dispute resolution management as part of HMRC’s litigation and settlement strategy and is now an integral part of the way HMRC does business.

According to HMRC, the intention is to try and minimise the scope for disputes and, wherever possible, handle them without confrontation and by working collaboratively with the taxpayer and its advisers. Discussions of risk in transactions occur on a “real time” basis, applying an “openness and early dialogue” approach between all concerned jointly agreeing on a timetable with key milestones and target dates for establishing facts, providing information and documentation, reviewing documentation, reaching decisions and testing conclusions.

At the heart of this approach is a shared “resolution” mindset that is likely to lead to a satisfactory outcome for both parties. This approach also extends to joint ownership and control of the dispute.

Such a collaborative approach also lends itself to the resolution of international tax disputes between contracting states and can
apply holistically from the very outset of a dispute, rather than when the MAP is formalised which to everyone’s frustration often is many years after the dispute has arisen.

What is needed is a mechanism that can apply long before MAP discussions begin and at the start of the ‘MAP Gap’, being the period between when an issue is identified, usually first by the multinational taxpayer, as being one with bilateral (or multilateral) consequences and often as part of a domestic audit in one only of the countries potentially involved and long before the prospect of formally activating MAP process is considered.

A CDR programme, including SDR mechanisms, would therefore complement and not compete with MAP. It would allow earlier engagement by all concerned, not only in a bilateral dispute but also a multilateral one (e.g. in transfer pricing cases), which otherwise requires a series of bilateral MAP processes to be initiated to achieve complete resolution of the case from the taxpayer’s point of view. Such a programme would also foster a more positive collaborative and collegiate relationship between the competent authorities and tax administrations of the countries involved as well as the taxpayers whose tax was the subject of the dispute.

It would improve efficiencies in the use of existing resources with consequent time and cost savings and potentially not only reduce but also avoid the need for litigation and arbitration and should also encourage better support for the BEPS project from the business community.

**SDR process protocol**

Although there is every reason to hope that the development of a CDR programme would assist parties in the management and resolution of their disputes themselves without the need for any third party intervention, experience shows that in practice the presence and participation of a trained facilitator can be the very catalyst to bring the parties together.

For that purpose, an SDR process protocol would be agreed using an SDR process agreement that would be entered into between the competent authorities involved and also the taxpayer.

It would set out a voluntary non-binding process and timetable for identifying and managing the issues and providing a menu of SDR techniques for that purpose from facilitation, non-binding expert determination as well as formal mediation and even, by agreement, arbitration of single or multiple issues.

The process could be run by a third party trained intermediary, either acting for all parties concerned or with each party appointing their own representative who would then work together, agreeing a timetable of facilitated structured discussions on the issues involved using the ‘decision tree’ approach.

The process could be initiated by one of the tax administrations or the taxpayer making a request to the other interested parties at the time when they believed the position had been reached in the formal pre-MAP and MAP process that needed a more facilitated approach.

The administration of the arrangements and the appointment of the facilitator could be organised by the parties themselves with the assistance of the Permanent Court of Arbitration (PCA) that has already indicated its willingness, in principle, to be involved in such an initiative. Practical issues such as the need for a panel of independent facilitators, their selection and the payment of their fees (possibly through the PCA itself) have already been discussed.

**Next steps**

A significant amount of work has already been undertaken in this area – not least by the OECD itself many years ago. Other countries are now starting to consider the use of SDR. The Finnish tax administration is to deliver a presentation on a cross-border dialogue (CBD) initiative at the next FTA Map Forum meeting in December 2017. The CBD is an initiative for tax administrations to enter into bilateral or multilateral dialogue in respect of specific tax issues in advance or in real time with a view to preventing tax disputes.

The CBD initiative should complement and fit well with another OECD initiative, ICAP (International Compliance Assurance Programme), which has been developed by 11 tax authorities with a pilot study commencing in January 2018.

The opportunities and support are already out there to harness all this work through the design and management of a holistic CDR programme, possibly in conjunction with the FTA MAP Forum strategic initiative.

A CDR programme with SDR mechanisms is not an alternative to arbitration. It would complement it and would even assist the parties in the pre-MAP period to resolve disputes much earlier (and without the need for litigation), providing the business community with the certainty it needs and delivering savings in costs and resource to all.

The international business community needs something more than the option of mandatory binding arbitration and the long period of years of uncertainty whilst that process takes its course. The use of SDR mechanisms as part of a CDR programme could hold the answer.