International tax dispute resolution: Breaking the impasse

Peter Nias, international tax specialist barrister at Pump Court Tax Chambers in London, analyses trends in international tax dispute resolution, looking at alternative dispute resolution methods and whether the OECD's recent work in this area represents a missed opportunity.

Statistics published by the OECD in November showed that international tax disputes have more than doubled in the last seven years with more than 2,200 new mutual agreement procedure (MAP) cases initiated in 2014. With many governments adopting both a more aggressive approach to tax audits and unilateral tax policies to manage tax avoidance and profit shifting, this upward trend is likely to continue in the foreseeable future unless something is done.

That position has been potentially exacerbated by the base erosion and profit shifting (BEPS) initiative launched in 2013 by the OECD and G20 countries to introduce coherence in the domestic rules that affect cross-border activities, reinforcing substance requirements in existing international conventions and improving transparency as well as certainty.

That risk was implicitly recognised by the OECD when they included as one of their action items (Action 14) the development of solutions to address obstacles preventing countries from solving treaty-related disputes.

The focus then was on mandatory universal arbitration but after two years of discussion on the issue, only 20 countries emerged to declare their commitment to provide for mandatory binding mutual agreement procedure (MAP) arbitration in their bilateral tax treaties as a mechanism to guarantee that treaty-related disputes would be resolved within a specified timeframe.

The OECD recognised that the introduction of measures developed to address base erosion and profit shifting should not lead to unnecessary uncertainty for compliant taxpayers and to unintended double taxation. Improving dispute resolution mechanisms is therefore seen as an integral component of the work on BEPS issues. In fact, governments need to show multinational enterprises that there is an effective and efficient mechanism and procedure in place to resolve a cross-border tax dispute if they are to win the support of the business community to the BEPS changes.

The BEPS Action 14 Final Report was published at the beginning of October. Its recommendations have been endorsed by all the OECD and G20 countries, and this in itself is significant. It identified 17 measures comprising a 'minimum standard' to which countries will commit and have their implementation of that minimum standard monitored through a peer-based monitoring mechanism as well as a set of 11 best practices to complement that minimum standard being measures on which not all countries could agree and which therefore appear not to be either binding or subject to monitoring mechanisms.

Nevertheless, that monitoring mechanism, if effective, combined with the minimum standard changes proposed to the OECD model treaty and its commentary introduced into the bilateral treaty networks of each country by the multilateral instrument, must be welcomed.

It is notable that the body recommended for carrying out the monitoring will be the Foreign Tax Administrations' MAP Forum, formed some two years ago to ensure the principles embodied in double tax treaty conventions are properly applied. In November last year it produced a strategic plan, one of the key points of which was to introduce process improvements and discuss ways to enhance and streamline not only the taxpayer's involvement in case resolution but also introduce training programmes to develop and enhance the expertise of competent authorities.

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Shortcomings

While the content of the final Action 14 report should be welcomed, it has missed an opportunity to embrace a holistic approach to dispute resolution.

Many of the specific measures constituting the minimum standard and best practices had already been identified by the OECD some 10 years ago as best practices in the review they carried out commencing in 2004, which resulted in 2007 in MEMAP: the Manual on Effective Mutual Agreement Procedures.

However, a preliminary report in 2004 – 'Improving the process for resolving international tax disputes' – had identified as one of the joint working party's proposals the mandatory submission of unresolved cases to SDR – supplementary dispute resolution – noting that in the absence of any final resolution in the MAP process (for example, arbitration) taxpayers might be hesitant to make resource commitments to enter into MAP with little incentive on the part of competent authorities to take all steps necessary to resolve a case.

The 2007 report went on to identify a series of follow-up initiatives including the evaluation of forms of SDR – facilitated discussions, non-binding expert determinations, mediations – in situations for which it was suitable, the timeframe for "triggering" their submission, the taxpayer's role and direct participation in the process and work on the operation or procedural details including the form and publication and relationship for domestic law remedies.

Apart from a couple of paragraphs outlining how mediation (one of the mechanisms of SDR) could contribute to the dispute resolution process (paragraph 3.5.2 MEMAP 2007) the only other outcome was the introduction in the 2008 OECD Model Treaty Commentary of two paragraphs (paragraphs 86 and 87) offering contracting states the facility of utilising SDR mechanisms as part of the dispute resolution process.

The final Action 14 report made no mention of SDR or the work and recommendations from these two earlier reports. While disappointing, and an opportunity missed, it is perhaps unsurprising for the following reason. At the open day that the OECD hosted in Paris in January 2015 to review the Action 14 draft recommendations, it was suggested by a senior OECD official that mediation and SDR had no place in international dispute resolution, evidenced by the fact it had attracted little, if any, use.

However, this begs the question. If you do not know what mediation is, do not know how it can benefit you and do not know where to turn to for the assistance, the opportunities (and benefits) are likely to pass you by.

As the MEMAP report observed (at paragraph 3.5.2):

"… The use of a facilitator/mediator should help provide a perspective on the discussions, identify process hindrances, and also bring more of a problem-solving focus to the discussions … It allows the competent authorities to view a specific case, or the MAP process itself, from a much different perspective. This perspective, perhaps acquired through the restatement by the facilitator/mediator of the positions or of the critical issues, may illuminate elements of the case or of the MAP process that are not perceptible when viewed from the standpoint of administration defending an adjustment or one that has been asked to provide relief.

The primary responsibility of the facilitator/mediator is the clear identification and reinforcement of the goals of the MAP proceedings, clarification of facts, objectively restating positions, and ultimately seeking opportunities for resolution. The neutrality and impartiality of the facilitator/mediator is crucial to a successful outcome."

One other point that deserves emphasising is that the SDR process is voluntary. No parties to it are forced to hand over the case to the mediator/facilitator – thereby relinquishing control and 'sovereignty' as in the case of an arbitration. The mediator/facilitator is in control of the process, but the parties remain firmly in control of the outcome.

Collaborative dispute resolution

At that Paris meeting, this author recommended the introduction of a collaborative dispute resolution (CDR) programme which would provide an holistic approach to dispute resolution starting well before the formal point at which MAP was triggered to improve the whole 'dispute experience' including a risk assessment for the selection of cases for audit and a review of the pre-MAP audit experience with the programme coordinated across countries not in a piecemeal approach.

The programme would develop a collaborative working environment between competent authorities and taxpayers and produce a best practice protocol from when the 'dispute' was first identified using the full range of SDR techniques and backed up with a training, educational and support programme together with access to third-party mediators and trained facilitators. It would complement MAP allowing earlier engagement and, significantly, be a non-binding process to which the parties would commit but remain in control of the outcome.

The CDR programme would promote a more positive collaborative and collegiate relationship not only between competent authorities but also with the taxpayers involved in the dispute.

Also conspicuous by its absence from the Action 14 Final Report was any recommendation for greater taxpayer involvement in the process, notwithstanding that, as a formal matter, it is a dispute between two (or more) sovereign states.

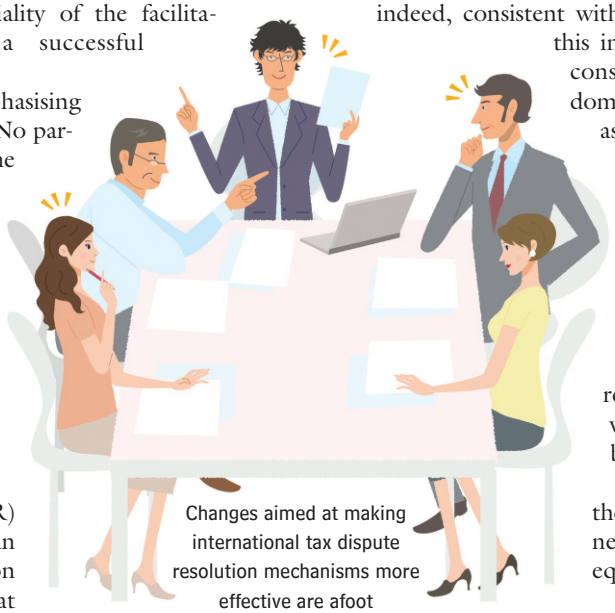
The CDR programme would improve efficiencies and in the use of existing resources produce savings not only in time but also cost as well as encouraging better support for the BEPS programme itself from the business community.

Ironically, the combination of the Action 14 Final Report and the FTA MAP Forum Strategic Plan endorse, albeit by implication, the concept of a CDR Programme.

Who will take this forward?

However, what is needed is for a body – be it the OECD or some other organisation – to carry out that further work identified by the OECD in its 2007 report to provide an understanding of what SDR techniques are, how they can benefit the international tax dispute resolution process in advance of invoking MAP and where to go for assistance in their use.

It would appear perfectly open to the FTA MAP Forum and, indeed, consistent with their strategic plan to take forward this initiative and develop a programme in consultation with member states with domestic dispute ADR programmes (such as the United Kingdom) and existing practitioners in this field.



Changes aimed at making international tax dispute resolution mechanisms more effective are afoot

In the United Kingdom, after a number of successful pilot studies, the use of ADR in managing tax disputes was introduced as 'business as usual' by the UK tax authorities in 2013. In the 12 months to June 2015, some 450 cases had been resolved through the ADR programme with a success rate of more than 75% being either fully or partially resolved.

These impressive statistics speak for themselves, and emphasise the effectiveness of ADR processes which can apply equally well in the international context.

The BEPS Project now is in its implementation phase with changes needed both to domestic tax codes and bilateral treaty provisions; the latter requiring a multilateral instrument.

However, as far as dispute resolution is concerned, there is no need to wait. The material and opportunity is already there as is the legal basis for all countries with MAP provisions in their treaty network based on Article 25 of the OECD Model Convention and incorporating the specific provisions allowing those contracting states to engage through consultation trying to agree a process for dispute resolution. That process, as the OECD Commentary makes clear in paragraphs 86 and 87, can include SDR techniques.

The tools to manage the growing impasse are already out there, they just need to be activated to break it. All that is required is a simple initiative on the part of one or more contracting states or the taxpayer whose tax position is the subject of the continuing dispute.