How to use hidden tools for managing international tax disputes

Taxpayers should not overlook the hidden tools in the MAP toolbox when it comes to dispute resolution, particularly supplementary dispute resolution (SDR). Here Emile Simpson and Peter Nias, from Pump Court Tax Chambers, write about the routes open to businesses.

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The issue this article addresses is how to manage the resolution of international tax disputes falling under Article 25 of the 2017 OECD Model Double Taxation Convention on Income and on Capital (the Convention) in a timely and cost-effective manner using the techniques of SDR.

By way of background, a key outcome of Action 14 of the OECD's 2013 BEPS Action Plan, which aims to make dispute resolution more effective, was the introduction of the mandatory submission to arbitration under Article 25(5) of the 2017 Convention.

However, we contend that dispute resolution under Article 25 can be made even more effective through the use of SDR both before, and after, the initiation of the mutual agreement procedure (MAP) by a taxpayer under Article 25(1).

What is SDR and its techniques? The initialism was first introduced by the OECD as part of its programme of work between 2004 and 2007 resulting in the 2007 Manual on Effective Mutual Agreement Procedures (MEMAP).

Its first report in 2004 referred to the existence of a number of possible SDR techniques and recommended an evaluation should be carried out of them and the situations for which they would be suitable.

SDR techniques – also referred to as non-binding dispute resolution (NBDR) techniques by the UN Tax Committee – cover a range of forms: facilitation, mediation, non-binding expert advice or determination.

Detailed analysis of these techniques and their application can be found in the IBFD 2021 publication '*Flexible Multi-Tier Dispute Resolution in International Tax Disputes*'.

However, the OECD focused on two forms: mediation and expert determination.

The MEMAP Manual recommended: "*the use of process-related assistance such as mediation or facilitation*" to help "*provide a perspective on the discussions, identify process hindrances, and… bring more of a problem-solving focus to the discussion*". Both paragraphs 86 and 87 to the OECD Commentary to Article 25 suggest using both mediation and expert determination to support the MAP process.

SDR techniques are not in opposition to arbitration, but rather, are exactly as labelled, supplementary techniques that will typically come into play earlier in the overall scheme of the MAP under Article 25, in order to encourage disputes to be resolved in as timely and cost-effective a manner as possible.

We consider first the legal basis of the use of SDR in relation to disputes falling under Article 25, and then address some common objections to the use of SDR.

The legal basis of the use of SDR under Article 25

SDR can be employed within the form of MAP set out in Article 25(1), under which the taxpayer presents their case to the competent authority in respect of "*taxation not in accordance with the provisions of this Convention*", which in turn triggers the obligation under Article 25(2) that "*the competent authority shall endeavour, if the objection*

appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State [...]".

SDR can be employed at any time before a mandatory submission to arbitration under Article 25(5) (notwithstanding its potential use thereafter, though that is not the focus of this article). Given that under Article 25(5), mandatory submission to arbitration can only be triggered by the taxpayer "*within two years from the date when all the information required by the competent authorities in order to address the case has been provided to the competent authorities*".

It may well be several years before any mandatory submission to arbitration. Even then, the arbitration process itself may be lengthy. It follows that the use of SDR before a mandatory submission to arbitration can provide a quicker, and therefore less costly, means to resolve the dispute.

However, and furthermore, SDR can also be used even earlier in a dispute, saving even more time and cost, in the period before Article 25(1) is engaged, that is, in the so-called "MAP gap" period when an issue that could develop into a dispute is first identified and before the formal notification of a MAP claim is made by the taxpayer.

When used in this way, the legal basis of SDR is under the first sentence of Article 25(3), which provides that: "*The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention.*"

Thus, Article 25(3) can cover the issues within any specific dispute – that is, a dispute relating to a specific taxpayer – that could potentially be brought under Article 25(1), since all such specific disputes would necessarily concern the application or interpretation of the Convention. But unlike Article 25(1), Article 25(3) does not require a taxpayer formally to trigger its application.

Article 25(3) allows the competent authority to take the initiative independent of or prompted by a request from, the taxpayer effectively to resolve a dispute with a taxpayer though a mutual agreement with the other competent authority at a very early stage in the dispute.

One example of where it could be used to good effect would be as part of the process of managing the pillar one approach to providing tax certainty (with respect to amount A). It could be used at any stage: before or as part of the optional initial review; the review panel or even the determination panel.

The taxpayer could not get a different result through Article 25(1), as the two competent authorities would be bound by their agreement on the issue under the Article 25(3) procedure. Rather, it would be in the interest of the taxpayer to take an active role in the Article 25(3) procedure – Article 25(3) is silent as to the taxpayers' role, but certainly says nothing against taxpayer involvement.

Furthermore, Article 25(3) is not limited to providing a "pre-Article 25(1)" means of dispute resolution in specific cases. Rather, it can be used to cover "*any difficulties or doubts arising as to the interpretation or application of the Convention*", which could include for example an issue that arises in multiple specific cases, which might involve more than two competent authorities. Naturally, the time and cost saved is multiplied in this scenario, should SDR successfully resolve the issue.

Every taxpayer needs a dispute toolbox

In summary, Article 25(3) has the effect of making the overall mutual agreement procedure under Article 25 more flexible, and thus more efficient. Indeed, the OECD's 2013 report on BEPS Action 14 was right to identify as a problem "*insufficient use of paragraph 3 of Article 25*".

Finally, it is important to note that the obligation under Article 25(3) is an obligation on both competent authorities, and is mandatory (i.e. "shall"), recalling the text: "*The competent authorities* [i.e. plural] *of the Contracting States shall endeavour to resolve by mutual agreement [...]*".

Further, while the obligation is not so high as to demand that the competent authorities resolve the issue, neither is it so low as to be a mere 'box ticking' exercise which might be satisfied, for example, by a nominal exchange of e-mails.

Rather, the requirement to interpret a treaty in good faith demands that a substantive and genuine attempt (i.e. *shall endeavour*) has been made to resolve the issue. The same "shall endeavour" obligation applies under Article 25(2), in the context of the taxpayer-initiated MAP process, which makes clear how it is central to the overall structure of Article 25.

Indeed, if the "shall endeavour" obligation were a mere box ticking exercise, Article 25(1)-(3) would be practically meaningless, and as such, would negate the object and purpose of those provisions; that cannot be right.

In fact the 2004 report also suggested (paragraph 132) that the MAP process could be improved with a mandatory requirement to submit certain unresolved cases to SDR procedures, such obligation possibly being viewed as "*arising from the general*

international law obligation to apply and interpret the treaty in good faith" and giving more content to the requirement in the Model Convention to "*endeavour… to resolve the case*".

In our view, it follows that, given the mandatory nature of the "shall endeavour" obligation, both competent authorities would have to have good reasons not to have at least attempted to resolve the issue by SDR.

Common objections around the use of SDR techniques

Mediation skills lie at the heart of all SDR techniques.

Mediation has been defined by CEDR (the Centre for Effective Dispute Resolution) as "*a flexible process conducted confidentially in which a neutral person actively assists parties in working towards a negotiated agreement of a dispute with the parties in ultimate control of the decision to settle and the terms of resolution*".

It is a voluntary process with the mediator in control of the proceedings (on a basis agreed with the parties) with the parties in control of the outcome and therefore not interfering with the national sovereignty of either state.

Whilst its voluntary nature has been criticised for not providing the certainty of a determined outcome, that factor is its very strength.

Human nature being what it is, where parties can engage with each other in an atmosphere in which they are not compelled by its process to accept the determination of a third-party, the taxpayer will be more willing to do so in the spirit of good faith. This would be with the assistance of an independent impartial third-party professional, potentially reaching more easily and efficiently an agreement on the issues in dispute. This would be a 'win-win' outcome for all concerned.

The flexible informal process has also been criticised for being too soft – 'fluffy' – lacking serious intent or the gravitas and formality of judicial proceedings. However, this is to ignore what lies at the heart of the process – to find a way of creating that very environment for both parties to feel more relaxed and confident and in that way better able to engage with each other.

It has been said the process has the potential to introduce more of a '*level playing field*' as the involvement of a neutral third-party increases the objectivity of debate and decreases the effect of '*inequality of arms*' where there is a difference in the skill sets and experiences of the parties involved

Critics also point to the term '*non-binding dispute resolution*' to highlight its shortcomings but this is to confuse the process with the outcome which is to facilitate the parties reaching a consensus agreement which is binding rather than to have a binding decision imposed on them.

Nor, in our view, is there a need for mediation to be a feature and part of a country's domestic law before a contracting state can engage in its use in the management of international tax disputes. The mere fact that a country has entered into a double tax treaty and committed to its terms gives it the mandate to use the SDR toolbox.

> "This would be a 'win-win' outcome for all concerned"

The way forward

The challenges regarding how to apply the Article 25(3) & (4) provisions are more practical than technical or theoretical.

How does the process work? Who organises the logistics and makes the appointments of the third party professionals? How is all this paid for?

All this can be brought together with the parties entering into an SDR Process Protocol for managing the process and is designed to complement (not compete with) MAP.

The SDR Process Protocol concept is based on the experience of using alternative dispute resolution techniques successfully in the UK domestic tax dispute management programme.

The SDR Process Protocol would be entered into by the competent authorities but also anticipate that the taxpayer could be invited to have some participation in the process.

It would introduce the issue(s), appoint a coordinator to coordinate the implementation and management of the protocol and liaise with the parties to agree a variety of administrative points comprising a menu of processes as appropriate from facilitated discussion, non-binding expert determination, mediation and, possibly, single or multiple issue arbitration.

The protocol would provide a timetable for how the various stages should proceed (including the appointments as appropriate of a facilitator, mediator, expert determinator and arbitrator), contain rules of conduct, confidentiality, the recording of action points and the content of an exit document.

Such a document would set out any agreement reached on the issues or the narrowing of the scope of the negotiation through review and discussion of the facts and arguments with a view to making more efficient any MAP Arbitration proceedings on any issues not agreed.

There is no reason why a couple or a group of EU member states could not consider getting together with a view to using this initiative in a pilot study programme where they jointly identify active or prospective cases where this process could be tested.

No mystique should be attached to SDR techniques: they are just tools in a toolbox. However, they need to be properly understood as does the most appropriate way to deploy them.

Ultimately, the use of SDR as envisaged in Article 25 alongside mandatory submission to arbitration promotes the objective to resolve international tax disputes in a timely and cost-effective manner.

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Emile Simpson is a barrister at Pump Court Tax Chambers. Emile practices in all of Chambers' core areas, as well as in commercial law and international law (in which he holds a PhD from King's College London). His interest in tax treaty arbitration is at the intersection of all three of these areas. More broadly, Emile is a specialist advisor in economic (including trade) and financial sanctions.

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