Unlocking MAP disputes

Is mediation the key?

Item 14 of the OECD's Action Plan on base erosion and profit shifting (BEPS) aims to devise solutions to obstacles preventing countries from resolving cross-border disputes under the mutual agreement procedure (MAP). Joe Dalton investigates whether introducing mediation techniques to the MAP process is a viable solution.

"A mediator's role may offer an opportunity for the competent authorities to view a specific case, or the MAP process itself, from a much different perspective. This perspective, perhaps acquired through the mediator's restatement of the positions or of the critical issues, may illuminate elements of a case or of the MAP process that are not perceptible when viewed from the standpoint of an administration defending an adjustment or one that is being asked to provide relief. In this regard, mediation may assist in resolving some of the more systemic issues of a MAP relationship."

It may be surprising to discover that the excerpt above is an entirely overlooked piece of guidance contained within the OECD's 2007 *Manual on Effective Mutual Agreement Procedures (MEMAP)*.

John Avery Jones, of Pump Court Tax Chambers alternative dispute resolution (ADR) unit, who has chaired arbitration panels under the EU Arbitration Convention and tax treaties, says despite this passage being contained in the MEMAP, he is unaware of any countries actually using mediation, as opposed to arbitration, to resolve disputes under MAP.

"I think that getting the use of mediation and facilitation in MAP cases back on the discussion agenda is a positive thing," says Avery Jones. "If mediation started to be used and led to the MAP process being a smoother more efficient process then I think that

would make it enormously more attractive to taxpayers."

The MAP problem

Last month, the OECD published statistics on the outstanding MAP caseloads of its member countries for the 2012 reporting period, including a breakdown per country of new cases initiated each year between 2006 and 2012.

These statistics reveal that at the end of the 2012 reporting period, the total number of open MAP cases reported by OECD member countries was 4061, a 5.8% increase as compared with the 2011 reporting period and a 72.7% increase compared with the 2006 reporting period.

The average time for completion of MAP cases in the last year was 23.2 months, which has reduced from a high of 27.3 months in the 2010 reporting period, but still remains higher than the reported resolution time between 2006 and 2009.

So we know the number of pending MAP cases is rising, and cases are taking an average of almost two years to resolve.

That in itself reflects a problem which needs to be addressed. However, the story does not end there.

The number of jurisdictions involved in MAP cases is ever increasing, which puts an obvious burden upon resolution times.

Diane Hay, special adviser for international tax at PwC, and the UK competent authority from 1991 to 1993 and from 2004 to 2008, says as more nations implement transfer pricing rules and are doing investigations and making adjustments, the MAP world is getting bigger.

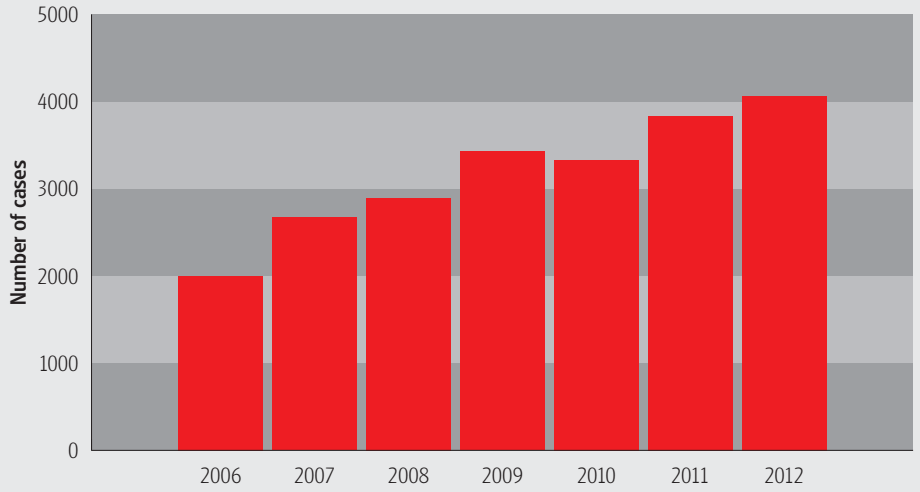
"The whole footprint of MAP is growing quickly. We now see cases with Korea, the Far East and many more cases in Europe. A lot of these new cases are coming in from countries with limited experience of MAP and limited experience of transfer pricing," says Hay.

"For example, there are now two series of bilateral MAP meetings a year between India and the UK. That has obvious logistical and time constraint impacts as this may well involve several weeks of work to get ready for all those cases and then to do the follow up as well," she adds.

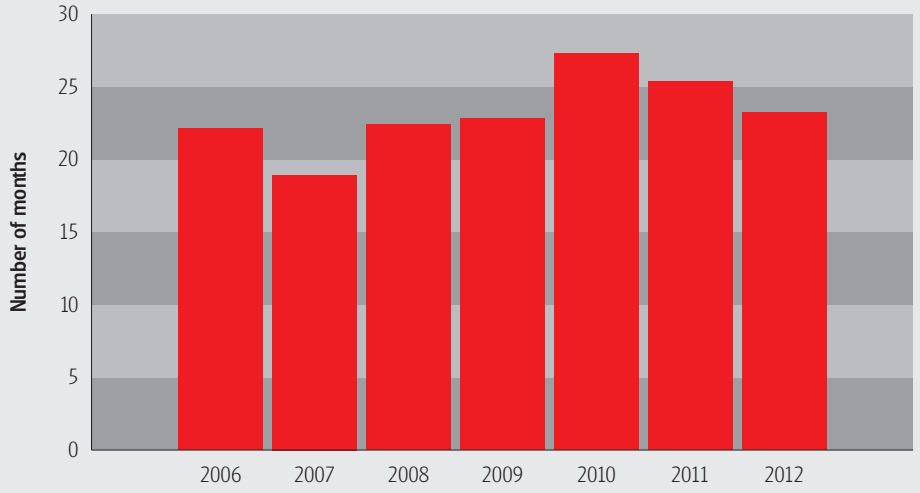
Another worry is that if unresolved MAP cases begin to pile up, it can cause political tension between states.

US competent authority Michael Danilack openly criticised recently ousted Indian competent authority SK Mishra at the Pacific Rim Tax Institute in February, citing a backlog of more than 140 double tax cases the countries had been unable to resolve through the MAP and advising US companies not to pursue bilateral advance pricing agreements with India as a result.

Inventory of MAP cases of OECD member countries at end of reporting period



Average time for the completion of MAP cases with other OECD member countries



Source: oecd.org

How could mediation help?

Peter Nias, a barrister also of Pump Court Tax Chambers ADR unit and Centre for Effective Dispute Resolution accredited mediator, says the BEPS commissioners at the OECD should look within their own MEMAP document for one of the potential solutions to the increasing MAP caseload of its member countries.

"This would involve either a formal mediation, using a single mediator appointed by both competent authorities, or, less formally, the appointment by each competent authority of a facilitator trained in mediation techniques to represent both countries in assisting the MAP process," says Nias.

Increasingly, jurisdictions are inserting arbitration clauses into MAP provisions, which have the effect of requiring competent authorities to try and resolve the issue by agreement or face a judicial determination through arbitration being an event outside their control.

Nias believes the use of mediation/facilitation allows both competent authorities to keep control of the matter while benefiting from the use of a skilled independent intermediary to help facilitate the settlement of cases before they reach the stage of arbitration, with savings in time and costs for all.

"After perhaps a year of little or no progress the competent authorities could consider bringing in somebody to reset the

process either through a facilitation or more formal mediation. I think what we have learned domestically in the UK is that a facilitator can unlock problems – they can get the parties to adopt a different approach and resolve misunderstandings. Even if that does not entirely resolve the issue, the use of a mediation/facilitation process could certainly clarify the issues and narrow the number of issues that are in dispute, which makes a more efficient process thereafter," says Nias.

Such an intervention would not require amendments to any treaties given that mediation could only be introduced if both countries were happy to use it since, by its very nature, mediation must be a collaborative process and so does not bind either party to do anything.

If the idea were to be taken forward, one of the issues to be addressed is how and from where each side appoints their designated facilitator or mediator.

Avery Jones says it may be difficult in practice for smaller countries for instance, to reach out into pools of professional mediators in countries such as the UK to appoint someone for their case.

And Hay says the importance placed on national sovereignty by some jurisdictions might be a stumbling block.

"Particularly for some of the smaller countries that have not got the experience of transfer pricing, and also culturally it would be incredibly difficult for them to give away what they see as their national sovereignty over tax matters to a foreign mediator," says Hay. "While if they had someone from their own jurisdiction and it was clear they were working under the direction of the tax authority then that might help. But I don't really think that gives them much credence as a mediator because you want somebody really who is bringing an independent view."

Nias suggests ideally the OECD would take the lead on introducing mediation techniques and processes into MAP cases and put forward detailed guidance on how and when mediators should be appointed, and perhaps providing its own list of go-to mediators, as part of the BEPS project.

One advantage of this for the OECD is that it would represent progress with respect to the BEPS Action Plan and, unlike many of the other action points, it would be easily achievable within the two-year timeframe and would be unlikely to cause any controversy.

Competent authority relationships

Though mediation has already begun to prove itself as a useful tool for resolving large and complex tax disputes in a domestic environment in countries such as the Netherlands, the UK and the US, Hay says the nature of competent authority relationships restricts its efficacy in a MAP context.

"From the competent authority point of view, there you are looking much more, not from an individual case perspective, but often from a much broader perspective about the whole relationship between country A and country B. That is where I think having a mediator for one case is going to be a difficulty," says Hay.

"The way competent authorities work best is if there is a strong relationship between two tax authorities and they have an equal interest in getting cases resolved, which tends to work best where you have a balance of cases. For example, with the UK and US there is a portfolio of cases where the UK has made the adjustment and a portfolio of cases where the US has made the adjustment, and the competent authorities come together to achieve resolution albeit on a case-by-case basis, but in the knowledge that what they give way on for one issue, they are likely to claw back on another issue," says Hay.

Working in this broad manner, where there is likely to be a balance of interests and reciprocity between competent authorities, means the introduction of a third party mediator who is not privy to the wider relationship, would have to be carefully managed.

"You could ask if a mediator would help you get to the final result any quicker, and I suppose there is a chance it might, but you would need a mediator working on every case to have that overall impact and awareness of the balance of interests," says Hay.

Nevertheless, there are cases that enter the MAP process which drag on for years or a few even fail to reach a resolution altogether, and Hay accepts mediation could have a role to play in such instances.

One obvious example was the failure of the MAP process in the case of UK healthcare multinational Glaxo SmithKline (GSK). The Internal Revenue Service (IRS) tried to adjust the profits of GSK subsidiaries in the US, arguing that they had been under-rewarded for their role marketing drugs developed in GSK's UK laboratories.

GSK invoked the MAP under the UK-US double tax treaty, hoping that HM Revenue & Customs (HMRC) would make the IRS wholly or partially back down, or if profits allocated to the US were increased, a corresponding decrease would be made in the UK.

However, the MAP negotiations broke down and GSK eventually settled the matter by paying an out-of-court settlement to the IRS, with the overall cost to the group reported as being between $3 billion and $4 billion, depending upon how it is measured.

"That is the sort of case where I could see a mediator would love to get involved and which might, because it is so exceptional and out of the normal range of cases, require something more than the normal MAP procedure," says Hay.

The OECD's 2007 MEMAP shows that introducing mediation to help speed resolution of MAP cases is something it has already given consideration to, though perhaps countries were not ready for it at that time because there was little experience of domestic mediation or the impetus to address flaws in the MAP process was lacking.

With the arrival of the BEPS Action Plan, it is a pivotal moment to bring mediation back onto the discussion agenda, and perhaps it will take the OECD to push harder for its use, or for two more experienced states to try the process in one of their own MAP cases, before we can really assess its true merits in a cross-border context.

Though looking at the way the idea appears to have been overlooked in 2007, it may be a case of now or never.

Trend towards arbitration

One answer to accelerating the MAP process which a growing number of countries are now incorporating into their treaty policy is the insertion of arbitration clauses.

The UK has said it intends to insert arbitration clauses into new and existing tax treaties, while Germany and the US are two other major jurisdictions among many following the trend.

Arbitration usually takes one of two forms: baseball arbitration, where the parties present a final offer and the panel chooses one or the other, and the more traditional approach where the panel decides on a figure within a range of possible values.

It offers several benefits:

- The arbitration panel is independent, which aids smaller, less experienced competent authorities negotiating with larger, developed jurisdictions;
- It incentivises competent authorities to speed up negotiations because otherwise the case will be decided for them by a panel; and
- It guarantees an end result in the case.