

Q&A

The new directive on tax dispute resolution mechanisms

Speed read

On 10 October 2017, the Council of the European Union adopted the Directive on Tax Dispute Resolution Mechanisms in the European Union ('the Directive'). The Directive expands on an existing framework introduced by the Union Arbitration Convention to create a time-framed, mandatory dispute resolution procedure covering a wider range of disputes. The changes provide for a more expansive guarantee of taxpayers' rights through greater access to an effective dispute resolution mechanism with an enforceable final outcome.



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What has happened?

In October 2016, the Commission announced a set of corporate tax reforms, including a proposed Directive on double taxation dispute resolution mechanisms in the EU. Following this, the Directive was adopted in October 2017 and must be implemented by member states by 30 June 2019, with complaints under the dispute resolution procedure being received from 1 July 2019.

What is the background?

Double taxation occurs when different member states tax the same income or capital in the hands of the same taxpayer, and for the same period. Disputes arise between taxpayers and member states when agreements (such as bilateral tax treaties) providing for the elimination of double taxation are applied or interpreted inconsistently by member states. The European Commission estimates that there are currently over 900 double taxation disputes within the EU, worth over €10.5bn. This number is likely to increase significantly, since tax administrations of member states have established more frequent and focused audit practices.

The disruption caused to businesses by double taxation cannot be underestimated. Broadly, double taxation undermines tax certainty in the EU and is seen as contrary to the principle of a single internal market. Double taxation hinders cross-border business

and investment by hampering cash-flow and escalating administrative and compliance costs. An ineffective regime for the resolution of disputes concerning double taxation plays a part in failing to prevent and discourage tax evasion.

What are the key reforms?

The Directive reforms existing double taxation dispute resolution mechanisms in significant ways.

Broader scope

To begin with, the Directive is much broader in scope than the Union Arbitration Convention (formally, the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises). The application of the Union Arbitration Convention is restricted to cases involving transfer pricing or the attribution of profits to permanent establishments. As a result of this, the Union Arbitration Convention applied only to 'enterprises'. The Directive, on the other hand, applies to all cases of application (or interpretation) by member states of double taxation agreements and conventions. It encompasses both companies and individuals as 'affected persons', provided that the dispute relates to tax that is within the scope of a double taxation agreement.

Prescribed procedure

The Directive will place an obligation upon member states to follow the prescribed dispute resolution procedure to eliminate double taxation disputes, with the procedure culminating in a binding decision. This is a departure from existing dispute resolution mechanisms, which do not impose formal obligations upon member states to eliminate double taxation. The Union Arbitration Convention does not include an overall time limit for the resolution of disputes, and the time restrictions for some phases (such as the time for competent authorities designated by member states to refer cases to the Advisory Commission) could be waived. The monitoring exercise undertaken in respect of the Union Arbitration Convention revealed serious concerns around the length of the dispute resolution procedure. The Directive now provides fixed timelines for every phase of the dispute resolution procedure, resulting in a clearer timeframe for the overall resolution of a dispute. Whilst this clarity is welcome, the resolution of a dispute under the Directive could still be time consuming, and in some cases take over four years from the submission of a complaint to the ultimate resolution of the dispute.

The mutual agreement procedure and dispute resolution procedure are the lynchpin of the Directive. The mutual agreement procedure is triggered by an 'affected person', who must submit a complaint to the competent authorities of member states within three years from receipt of the first notification of the action resulting in the question in dispute. The competent authorities of the member states must endeavour to resolve the dispute within two years, a term which is extendable by an additional year at the request of a competent authority, providing written justification.

If the competent authorities of member states are unable to reach an agreement, two options are available:

- an Advisory Commission; or
- an Alternative Dispute Resolution Commission, can resolve the dispute.

Whereas the Advisory Commission arrives at its decision through an 'independent opinion process', an Alternative Dispute Resolution Commission has the flexibility to adopt 'any other type of dispute resolution process'. These commissions have six months (extendable to nine months) to deliver an opinion. The competent authorities of the member states must then agree how to resolve the question in dispute within six months of the notification of the opinion. While the competent authorities may, even at this stage, take a decision which deviates from that of the Advisory Commission or Alternative Dispute Resolution Commission, they are bound by that opinion if they fail to reach agreement.

The final decision shall be binding on member states but shall not constitute a precedent. It shall be implemented subject to all affected parties accepting the decision and renouncing any right to a domestic remedy. When implemented, the member state shall, where necessary, amend its taxation irrespective of time limits. Where the decision has not been implemented, the taxpayer may apply to a competent court in order to enforce the implementation.

By extending to the full spectrum of double taxation disputes, prescribing a binding dispute resolution procedure and setting out clear timelines and enforcement mechanisms, [the Directive provides] for a clear mechanism to resolve double taxation disputes

Final thoughts?

The Directive introduces important (albeit not radical) substantive changes to the regime for resolution of double taxation disputes. By extending to the full spectrum of double taxation disputes, prescribing a binding dispute resolution procedure and setting out clear timelines and enforcement mechanisms, these changes aim to enhance EU tax policy and encourage a pro-business tax environment, while providing for a clear mechanism for taxpayers and member states to resolve double taxation disputes effectively when they occur.

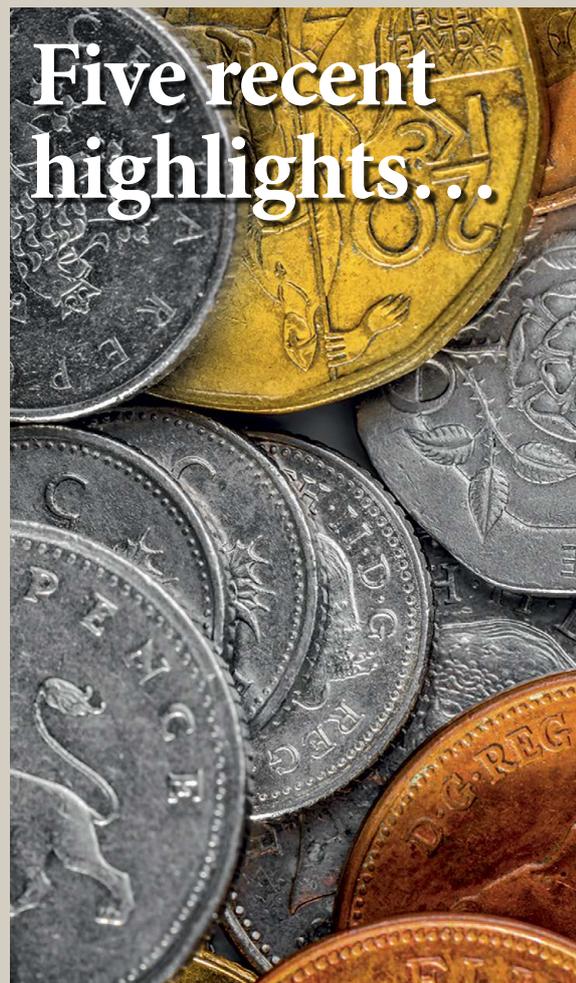
In the absence of a wider harmonisation of tax law, a coordinated EU tax policy sustains wider economic relations between member states and contributes to the EU's competitiveness as a global economy committed to cross-border business activity. Acknowledging that there is still some scope for adjudicative bottlenecks under the new regime, the Directive is, although not a giant leap, at least a giant step in the direction of greater legal and tax certainty.

It remains to be seen how the UK will react to these developments in the context of Brexit. Adopting this mechanism in the UK's treaties and its domestic law, will be a step in the right direction. ■

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