Analysis

Dispute resolution through mandatory binding arbitration

Speed read

The International Chamber of Commerce (ICC) United Kingdom has been investigating the practical aspects of using the mutual agreement procedure (MAP) and arbitration processes to assist in resolving international tax disputes. The work is in the context of the BEPS Action 14, which deals with dispute resolution. ICC United Kingdom has responded to the OECD's Action 15 discussion draft on producing a multilateral instrument, which raised questions about dispute resolution. Its response drew on the results of a survey conducted with Pinsent Masons. With data on 58 international tax disputes, the survey highlighted the need for improved standards based on practical problems that UK corporates currently encounter, particularly when trying to use the MAP. Respondents demonstrated a clear support for introducing mandatory binding arbitration and for greater taxpayer involvement in the arbitration process.

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Implementation of the OECD's base erosion and profit shifting (BEPS) initiative will reshape many well-established norms of international tax. As these new norms gradually develop, an increase is predicted in disputes between tax authorities over taxing rights and the quantification of profits.

The BEPS action plan includes two provisions under Action 14 which should help multinationals that regularly find themselves in dispute over international transactions with one, two or more tax authorities. First, 20 countries – including major players in international business – have committed to work together to establish mandatory binding arbitration (MBA) provisions in their treaties. Second, there is a commitment to minimum standards and best practice for dispute resolution.

ICC United Kingdom sees a significant opportunity to assist the OECD and tax administrations in establishing truly effective MAP processes for dispute resolution, coupled with an equally effective MBA regime. ICC United Kingdom has set out to establish and develop an understanding of companies' practical experiences of, and the barriers to, resolving international tax disputes through the use of MAP/arbitration processes. It has recently used the initial results of a survey of major UK companies to inform a submission to the OECD, in response to a consultation on BEPS on the development of a multilateral instrument to amend bilateral tax treaties covering these matters (under BEPS Action 15).

Background to ICC United Kingdom's submission

ICC United Kingdom's submission was prepared using information and data collected from a survey of large UK based international corporates, conducted between April and June 2016. Largely conducted by Pinsent Masons on behalf of ICC United Kingdom, the survey was initiated to collect a fact base regarding the experience of UK corporates when attempting to resolve international tax disputes. The survey results were intended to guide ICC UK's response to the OECD's recommendations in relation to Action 14 and the resolution of international tax disputes.

The survey collected data on 58 international tax disputes. It focused on UK corporates' practical experiences of the current MAP and arbitration processes, based on the OECD Model Tax Convention and the EU Arbitration Convention (EUAC), in relation to disputes between the 20 countries that have agreed to commit to mandatory arbitration. The survey also sought respondents' views on the OECD's proposals to introduce an optional provision for an MBA procedure as part of the MAP; and for minimum standards to be introduced for disputes resolved through the MAP. The minimum standards largely focus on the commitment by contracting states to behavioural changes when dealing with MAP disputes (e.g. commitment to timely resolution, ensuring that competent authorities have requisite authority and sufficient resources, etc.). The OECD intends to introduce a peer to peer review procedure to act as a deterrent to prevent contracting states from failing to comply with the minimum standards.

The current MAP is detailed in article 25 of the OECD Model Tax Convention and provides a procedure for resolving tax treaty disputes. (A detailed review of the current MAP and the OECD's proposals in Action 14 are outside the scope of this article, but readers are referred to the article 'BEPS and the future for cross-border dispute resolution' (Jason Collins), *Tax Journal*, 31 October 2015.)

Overview of ICC United Kingdom's submission

In brief, the survey highlighted a number of practical barriers that prevent or hinder taxpayers from effectively using the MAP and, where available, MBA. ICC United Kingdom recommended that the minimum standards should address these matters and be extended to cover the new MBA procedure.

For ICC United Kingdom, compliance with both the minimum standards and the MBA procedure is vital to ensure that international tax disputes are resolved effectively and to the satisfaction of both contracting states and the taxpayer. On this basis, ICC United Kingdom questioned whether the proposed peer to peer review mechanism will adequately incentivise contracting states to fully comply with the MAP/MBA procedures, or whether additional compliance mechanisms may be required.

ICC United Kingdom submitted that taxpayers should be able to participate independently in both the MAP and MBA processes; and have an independent right to call for a dispute to be resolved through MBA, whilst also being able to participate formally in the arbitration process.

Survey results

The survey asked a range of questions about international tax disputes. Topics covered included: issues engaging double tax agreements; experience of the MAP; and views on the BEPS Action 14 recommendations (including both proposals for MBA and the minimum standards). Both closed and open questions were included, with respondents encouraged to provide detailed comments, particularly on practical issues encountered with the effective use of current processes. The survey was conducted online and through telephone interviews with Pinsent Masons.

Not surprisingly for UK corporates, corporation tax was by far the most commonly disputed tax, while transfer pricing was overwhelmingly the most frequent issue in dispute. Disputes about liability for tax (residence/permanent establishment issues) also regularly arose.

There was very strong support for the introduction of an MBA procedure, with 100% of respondents considering this to be either 'necessary' or 'desirable'. Ultimately, UK corporates consider that an MBA procedure is an essential safeguard and that either one of the contracting states or the taxpayer should be able to call for a dispute to be resolved through arbitration.

The survey underlined the concerns of UK corporates that the current process to resolve international tax disputes is too lengthy. In general, corporates welcome the introduction of new robust minimum standards, but remain concerned that they will be limited without effective enforcement mechanisms to ensure compliance by all contracting states.

Current compliance with MAP obligations is variable, as is the application of the *Manual on Effective Mutual Agreement Procedures* (MEMAP). Whilst examples of good practice were found in some contracting states, the survey identified a number of specific barriers either to entry to the MAP process, or to the effective use of the process in a number of contracting states.

Problems with the MAP: some offenders

The survey identified several practices that discourage the resolution of international tax disputes through the MAP, by imposing barriers that prevent or delay its effective use. Whilst country-specific examples follow, it is acknowledged that there may be examples of good practices in those countries, and of bad practices elsewhere that were not extrapolated from the survey sample.

Several corporates cited issues invoking the MAP or the EUAC in Italy. Corporates mentioned complex interactions between Italian domestic processes and the MAP, whereby it was not possible to invoke the MAP while domestic processes for dispute resolution were in progress. However, once domestic processes had been completed, the MAP could not be invoked, on the basis that a decision made in the Italian courts was considered final, with the result that the MAP could no longer be pursued.

This was contrasted with experience in Spain, where domestic processes are paused when the MAP is invoked and are not resumed until the MAP has been completed.

It was also reported that in Italy MAP/EUAC settlements would attract significantly higher penalties than would apply to a resolution through administrative processes. In practice, this meant that resolution through the MAP was likely to be uneconomic compared to accepting a level of double taxation arising from a domestic administrative settlement.

Instances were cited of German tax authorities informing taxpayers that the adjustment being sought would be considerably greater if a claim to the MAP were made; and of proposing contractual waivers under which those rights were then foregone. This type of behaviour discourages the use of the MAP and is, quite rightly, contrary to the EUAC code of conduct.

In contrast, the survey highlighted that UK corporates have found both Spain and the Netherlands more receptive to MAP applications, with fewer barriers to entry being imposed to prevent the MAP being invoked.

Greater taxpayer involvement

Given the obstacles that UK corporates encounter when trying to resolve international tax disputes, coupled with being entirely at the mercy of how contracting states choose to conduct themselves, it is unsurprising that there was clear support for taxpayers having greater involvement in the dispute resolution process. Indeed, over 90% of respondents considered that taxpayers should have an independent right to participate formally in the arbitration process, including the hearing before the arbitrator.

The minimum standards

As noted above, many UK corporates encountered unreasonable delays in attempting to resolve international tax disputes. On this basis, there was a broad consensus that the time taken to resolve disputes needs to be addressed in the minimum standards. Many respondents suggested that an actual deadline for resolving tax disputes should be introduced.

The survey produced a number of examples where contracting states had been slow to resolve a dispute through the MAP. Belgium, Ireland and Italy were mentioned. In one case, it was reported that when a similar tax dispute arose between the UK and Belgium and the UK and the Netherlands, it took two years longer to resolve in Belgium than in the Netherlands.

Some companies suggested that tax authorities seemed to be using deliberate tactics to hamper progress, such as unreasonably denying qualification to enter the MAP or arbitration processes. There is no doubt that variable experiences across countries are a reality; however, it is unknown whether the causes are matters of deliberate tax authority practices or other matters such as resourcing levels and training.

The future

The survey has generated some interesting and informative results and provided a clear indication of the current problems in the international dispute resolution process. It has also shed some light on how these weaknesses might be addressed. Ultimately, we hope that with more robust minimum standards and an effective MBA procedure when disputes arise (at least in the 20 countries that have currently committed to MBA), contracting states will be encouraged to actively engage with taxpayers to reach a satisfactory and timely solution.

ICC United Kingdom and Pinsent Masons will continue to work together to engage with the OECD in relation to both Actions 14 and 15, to ensure that the revised international dispute resolution procedure through both the MAP and MBA is as robust and effective as possible. The authors of this article would welcome further input into the survey. ■

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- 30 questions on BEPS (Jill Gatehouse & Susanna Brain, 29.10.15)