Analysis

Dispute resolution procedures in the multilateral instrument

Speed read

The multilateral instrument (MLI) implements BEPS recommendations in several areas, including dispute resolution. Revised mutual agreement procedure (MAP) and transfer pricing corresponding adjustments wording will be included in treaties. Countries can choose to adopt mandatory binding arbitration (MBA). A recent ICC survey showed corporates were concerned about the lack of formal taxpayer involvement in MAP and MBA and the time taken to resolve disputes. Disappointingly, the MLI gives taxpayers no significant involvement in MAP or MBA. Although it looks as if the UK is going to sign up for the 'full deal', there is still scope for other states to drag their feet.

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In November 2016, the OECD published the multilateral instrument (MLI) designed to bring into force the double tax treaty aspects of the OECD's BEPS recommendations relating to hybrid mismatches, treaty abuse, artificial avoidance of permanent establishments and improving dispute resolution.

Last year, the International Chamber of Commerce UK (ICC) conducted a survey, in conjunction with Pinsent Masons, of the experiences of UK corporates in relation to international tax disputes. In this article, we consider how the dispute resolution measures in the MLI match up to the survey responses.

The MLI deals with three areas relating to dispute resolution:

- article 16 provides the mechanism to incorporate revised mutual agreement procedure (MAP) wording in treaties;
- article 17 covers corresponding adjustments as a result of transfer pricing disputes; and
- articles 18 to 26 set out a procedure for mandatory binding arbitration.

Mutual agreement procedure (MAP)

MAP provides a mechanism designed to resolve disputes concerning the application of a particular treaty. It requires the competent authorities (i.e. the tax authorities) of the two treaty states to engage with each other when a taxpayer claims that it is not being taxed in accordance with the treaty.

Action 14 of the BEPS report requires, as a minimum standard, the inclusion in tax treaties of a version of the MAP in article 25(1)–(3) of the OECD Model Tax Convention, modified to allow the taxpayer to present its case to either state. The current article 25(1) requires the case to be presented in the state where the taxpayer is resident.

The MLI provides that the modified version of MAP will apply to treaties in place of, or in the absence of, MAP provisions. States can make limited reservations. These include not allowing claims to be made to either state, but implementing a process whereby the state receiving the taxpayer's notification will notify or consult with the other state, if it does not consider the taxpayer's case to be justified. According to a Treasury and HMRC presentation on 12 December 2016, the UK will adopt article 25(1)–(3) in its entirety and will not make any of the reservations.

The ICC survey showed that it was considerably more difficult to invoke MAP in some states as compared to others; Germany and Italy were mentioned as being difficult. Having the choice of the state in which to invoke MAP will therefore be welcome. However, we do not yet know what position other states are taking on reservations and there will be concerns that states could use reservations to make it more difficult to use MAP in practice.

Peer reviews

Survey respondents expressed concerns that the new measures would be limited without effective enforcement mechanisms to ensure compliance by all contracting states.

The OECD commenced its MAP peer review and monitoring process under Action 14 of the BEPS action plan in December. Under this two stage process, the OECD first uses feedback on how MAP is working in practice to write a report; and then, in the second stage, monitors performance against the report's recommendations.

The first peer reviews of Belgium, Canada, the Netherlands, Switzerland, the UK and the US are underway. The OECD has moved on to consider Austria, France, Germany, Italy, Liechtenstein, Luxembourg and Sweden. It invited input (by 27 February 2017) on specific issues relating to access to MAP, clarity and availability of MAP guidance, and the timely implementation of MAP agreements for these jurisdictions. Feedback from groups will be crucial to the process and it is to be hoped that those who have had good or bad experiences will take the opportunity to participate in the process.

Corresponding adjustments

States are also required, as a minimum standard, to provide access to MAP in transfer pricing cases and to implement the resulting mutual agreement by making appropriate corresponding adjustments to the tax assessed; for example, when a tax deduction is reduced in one state, reducing the amount brought into tax in the second state. Article 17 of the MLI enables states to implement article 9(2) of the Model Convention, committing them to making the 'appropriate adjustment'. States can choose not to adopt this, if their treaties already contain the provision; or on the basis that they will make the corresponding adjustment, notwithstanding the treaty terms; or (getting into woollier territory), they will endeavour to resolve the issue under MAP. It is understood that the UK will adopt article 9(2).

Binding arbitration

Article 19 of the MLI sets out a mechanism for mandatory binding arbitration (MBA) where competent authorities are unable to reach agreement under MAP. It is optional and will

only apply to treaties where both states choose to apply it. At the time of the OECD report in 2015, 20 states had declared their commitment to provide for MBA. These were Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the UK and the US. In the end, 27 states participated in the OECD working group.

The MLI article 19(1) provides that where the competent authorities are unable to reach agreement pursuant to MAP within two years, unresolved issues will, at the request of the taxpayer, be submitted to arbitration. The competent authorities can agree a different time period for any particular case (perhaps due to its complexity), as long as they notify the taxpayer within the two year period.

States can choose to allow three years (rather than two years) for agreement to be reached under MAP before MBA is possible; and can choose to exclude issues which have already been decided by a court. The UK intends to choose to apply MBA without any of these adaptations.

Method of arbitration

The arbitration panel will consist of three independent and impartial members with expertise or experience in international tax. Each competent authority will appoint one member and then those two members will appoint a third member to chair the panel, who cannot be a national or resident of either state. There are provisions for an OECD official to appoint panel members, if states or the panel members do not make the necessary appointments.

States can choose which type of arbitration they want to adopt for their 'covered agreements' (article 23). Either:

- 'final offer' or last best offer arbitration (sometimes called 'baseball arbitration'): this is the default option, under which each competent authority will submit to the arbitration panel its proposed resolution; and (if it chooses) a supporting paper and a response to the other state's proposed resolution. The panel will decide, by simple majority, which resolution to accept. It will not give any reasons for its decision and the decision will have no precedent value; or
- 'independent opinion' arbitration: under this option, each competent authority provides the panel with 'any information that may be necessary for the arbitration decision'. The panel decides the issues and provides a reasoned decision. Again, the decision is by simple majority and it does not set a precedent.

If one party to the treaty has chosen independent opinion arbitration and the other has chosen final offer, independent opinion will apply to the treaty, unless the state which has chosen final offer has chosen not to apply MBA to treaties with states that have chosen independent opinion arbitration. In that case, MBA will not then apply unless the parties reach agreement on the type of arbitration process that will apply to that treaty. It is understood that the UK will adopt final offer arbitration and will not opt out of MBA for treaties with states which have chosen independent opinion arbitration.

The arbitration decision will be binding on both states unless the taxpayer does not accept the decision. It will also not be binding if a court holds that the decision is invalid or if a person directly affected by the decision pursues litigation in relation to the issues.

The states concerned will agree how costs will be borne. In the absence of agreement, each state will bear its own costs and those of the panel member they appointed, and the cost of the chair and any other expenses will be shared equally (article 25).

Article 21 sets out confidentiality obligations for the arbitration panel and their staff, to enable the tax authorities to disclose information to the panel without breaching domestic confidentiality requirements. States can also choose to apply a confidentiality provision to the taxpayer (article 23(5)). This would be an agreement by the parties and their advisers not to disclose any information received during the course of the arbitration from either state or the arbitration panel. MBA and the whole MAP procedure will end if the taxpayer or their advisers materially breach the agreement. Apparently, the UK will choose to apply confidentiality but will not make a reservation to disapply MBA where other states have specifically opted for confidentiality not to apply.

Article 24 is an optional provision for the arbitration decision not to be binding and not implemented if the states concerned agree on a different resolution of all issues within three months of the arbitration decision. This will only apply to a particular treaty if both states have made the reservation. The reservation can be made in respect of all treaties or only those where reasoned opinion arbitration applies. The Treasury has said that the UK will adopt this provision in relation to all its treaties.

States can reserve the right for the MBA provisions in the MLI not to apply to treaties which already provide for MBA. The UK will reserve the right to maintain any existing stronger MBA provisions.

Article 36(2) allows states to reserve the right for the MBA provisions not to apply to cases entering MAP before the MLI comes into force, unless the parties agree to MBA applying to that specific case. We understand that the UK does not intend to make this reservation. However, if the other party to the treaty makes the reservation, the practical effect will be that the benefits of MBA will not be available for a number of years.

The ICC survey showed very strong support for the introduction of an MBA procedure, with 100% of respondents considering this to be either 'necessary' or 'desirable'. However, over 90% of respondents considered that taxpayers should have an independent right to participate in the MBA process. It is disappointing therefore that the MLI provisions in relation to both MAP and MBA do not give the taxpayer any role in the process, other than being asked to provide information. For example, in relation to final offer arbitration, the taxpayer has no formal right to input into the supporting paper produced by the tax authority for the arbitration panel.

Outlook for the future

As we see the BEPS recommendations implemented, disputes are likely to increase. The first country by country reports may well bring the first wave, as there is a strong chance of states misinterpreting disclosures, due to the inadequacies of the CBCR template. An efficient dispute resolution system will therefore be even more critical in the future.

A major concern about the current system is the length of time it takes to resolve international tax disputes. The MLI provisions are definitely a step in the right direction, but there is still considerable scope for states to drag their feet in resolving disputes. Only time will tell whether corporates will see significant improvements in the process. ■

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- The multilateral convention to implement tax treaty related measures to prevent BEPS (S Bhogal & K Swanson, 19.1.17)
- Dispute resolution through mandatory binding arbitration (I Hyde & R Thomas, 21.7.16)
- BEPS & the future for cross-border dispute resolution (J Collins, 29.10.15)