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BEPS Action 14 vs Treaty Obligations and State Aids

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The OECD Public Discussion Draft on BEPS Action 14 (released on 18 December 2014) covers extensively dispute resolution mechanisms and ways to make them more effective. The subject has grown in importance as Mutual Agreement Procedures ("MAP") have increased significantly especially on transfer pricing cross border adjustments. In this context, the BEPS Discussion Draft states under Option 7 of Action 14 that "participating countries that allow their tax administrations to conclude audit settlements with respect to treaty-related disputes which preclude a taxpayer's access to the mutual agreement procedure could commit to take appropriate steps to discontinue that practice or to implement procedures for the spontaneous notification of the competent authorities of both Contracting States of the details of such settlements. Changes to the Commentary on Article 25 could also address the obstacles to an effective mutual agreement procedure created by audit settlements".

The subject suggests a debate on whether or not settlements in the international context require reconsideration in the light of BEPS and EU tax policy and whether we may expect a change either in their magnitude or in the fashion in which they are currently negotiated and concluded. Food for thought for both tax administrations and corporate tax groups. There is a consensus that settlements have proven to be a virtuous mean to reduce time consuming and administrative burden for both tax authorities and taxpayers. They also favor legal certainty which is otherwise affected by the long time frame which characterizes tax proceedings (in most countries final decisions are delivered several years after the adjustment has taken place). In most recent times, domestic tax laws and international organizations have expressed sympathy for tax settlements and other means of dispute resolutions. This being stated, the Draft rightly points out that audit settlements may sometimes be an obstacle to MAP access (Draft, paragraph 19) and tax authorities practice discouraging MAPs to be initiated after a settlement should be avoided. Monitoring these practices is not however an easy exercise.

It is in fact unlikely that settlements agreed by the taxpayers and the tax authorities expressly contain a condition not to pursue a MAP. On the one hand the tax authorities do not wish to expose themselves to criticism from the other Contracting States and on the other hand tax authorities are aware that they may exercise a moral suasion on the taxpayer who would unlikely upset its current relationship with the revenue authorities of its own State of residence. Furthermore, settlements are not easily visible as enhanced cooperation also recommended by international organizations as a tool for dispute resolutions drove to a move under which settlement are converted into a negotiation carried out during the audit which ends with an agreed adjustment which is not challenged by the taxpayer. The assessment is then the result of a compromise which takes place

during the audit. So, it seems there is not a mechanism to easily trace situations in which taxpayers and tax authorities have reached a compromise which the taxpayer does not initiates the MAP once or to the extent that the potential dispute is eliminated unilaterally.

One strong incentive for a unilateral settlement procedure is that settlements unlike MAP may provide for a significant penalties reduction either applied by operation of law or under the discretion of the tax authorities whereas the same reduction does not take place in the case of MAP. It is also not uncommon that the compromise includes a greater reduction of other (domestic adjustments) balanced by a lower reduction of the cross border adjustment. The intrinsic subjective nature of settlements is evidently an obstruction to transparency. The tendency briefly depicted above is even more true in countries where the penalties are relatively high and the fact that these can also be equal or greater than the amount of the adjusted tax, it would be desirable that domestic provisions should eliminate the trade-off between a domestic settlement and a MAP in order to grant the taxpayer the possibility to choose the most effective procedure for the case at stake without being driven by the savings constituted by different penalty regimes between settlement and MAP. In brief, taxpayers enacting a MAP should have access to the same penalties reduction provided for the domestic settlement procedures. This being said, the recent stringent attention of the EU Commission on State aids in tax matters in the context of APA triggers the following questions: (i) can a favorable unilateral settlement be seen as a State aid? (ii) is the conclusion of a settlement in breach of the Convention in consideration of the fact that the other Contracting State is excluded from the negotiation? and more over, (iii) should a unilateral settlement be made public and at least made available to the other Contracting State?

It is possible that Member States shall convert their APA practice which is under EU scrutiny into a settlement practice which fall outside the scope of the current focus of the EU Commission.

The question whether a favorable settlement may be considered a State aid comes from the analysis of the Commission Decision no. 2011/276/EU of 26 May 2010 (UMICORE), regarding a Belgian domestic settlement dispute mechanism; the Commission clarified at the end that tax authorities should have some leverage in dealing with such procedures, and only an "obvious excessive imbalance" in the settlement agreement can amount to an "advantage" for State aid purposes. That is, if "concessions made by the authorities are clearly out of proportion to the concessions made by the taxable *person, given the circumstances*", there may be an economic advantage that might fall within the scope of State Aid. Hence, in this particular case, the Commission did not reckon the Belgian settlement as constituting a State aid but, for the purpose our reasoning here, what matters is that the Commission clearly wanted to investigate on the facts and circumstance of the settlement suspecting a State aid could have been granted. In that particular case the settlement provided for a penalties reduction which in the specific case was held within the margin of appreciation of the national tax authorities in the light of existing national case law. Would the Commission end up with a similar decision in cases other than this where, for example, no case law substantiated the concession granted to the taxpayer in the framework of the settlement procedure? Finally, settlements may represent a violation of the EU Arbitration Convention insofar as the unilateral compromise is found to be an impediment for the taxpayer to initiate the arbitration procedure.

The recent announcement of a forthcoming proposal to extend the exchange of information directive to APA granted unilaterally by Member States – which information requirement follows previous recommendation by the EU Forum on Transfer Pricing – might therefore also be extended to unilateral settlements which may affect the taxable basis of another Member State and equally a

peer review should be proposed by the EU Commission to establish the extent to which Member States are unwilling to activate the arbitration convention and be ready to put under discussion and override the results of a unilateral settlement reached with the taxpayer.

Furthermore, it could be established that taxpayers be required to promptly inform the tax authority of the other Contracting State as to the conclusion of the settlement which procedure would relieve the tax authority concluding the settlement from the information requirement.

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