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International Tax Dispute Resolution and the BEPS Multilateral Convention: A Camel Safari

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"*A camel is an animal designed by a committee*" – Anonymous

In launching the BEPS programme in 2013, the OECD warned that replacement of the current consensus-based framework by unilateral measures, could lead to global tax chaos marked by the massive re-emergence of double taxation (OECD: Action Plan on Base Erosion and Profit Shifting (2013)). The BEPS actions themselves have raised the prospect of increased risks of double taxation caused by uncertainty introduced by rule changes and uneven implementation of those changes by states around the world.

In light of this BEPS Action 14 aimed at improving the international tax dispute resolution process. Traditionally disputes in the tax treaty area have been resolved by mutual agreement (MAP) between the competent authorities of contracting states in line with article 25 of the OECD Model Tax Convention. The most important limitation on this process is that competent authorities cannot be compelled to resolve the dispute.

Mandatory binding arbitration has been advanced as the best way to effectively resolve tax treaty disputes. Provision for such arbitration was included in the OECD Model Convention in 2008 and has been include in bilateral treaties by a few countries. Similar arbitration is available in the EU for transfer pricing under the EU Arbitration Convention.

There is no consensus among OECD and G20 countries on the adoption of arbitration as a dispute resolution mechanism. Only a small sub-set of the 100 countries that have shown interest in the BEPS Convention have expressed interest in mandatory binding arbitration. They are: Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States. The group is around half of OECD member countries and only 13 of the present 28 EU Arbitration Convention participants. These countries do however represent the overwhelming majority of outstanding MAP cases. One effect of the BEPS project will be to expand the number of countries involved tax treaty disputes where no such mechanism is in place.

The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS Convention) by the OECD on 24 November 2016, Part IV, contains detailed provisions for an optional arbitration mechanism that states may sign up to as part of their participation in the BEPS Convention.

Mandatory Binding Arbitration

The basic mechanism of the existing OECD Model is followed. Thus any issue that remains unresolved two years after the taxpayer presented the case to the competent authorities must be submitted to arbitration if the taxpayer so requests. The arbitrators' decision is binding on the states unless the taxpayer does not accept the decision or the arbitration is held to be invalid or if the taxpayer pursues the issues through the judicial process of the contracting states.

Contracting states may reserve the right not to accept arbitration or for an arbitration that is on foot to be terminated if a decision on the issue is rendered by a court or administrative tribunal of either contracting state. Arbitration proceedings will also terminate if the competent authorities reach agreement on the issue before the arbitrators deliver their decision.

How binding is binding?

Unlike article 25(5) of the OECD Model and the EU Arbitration Convention, The BEPS Convention offers states an opt-out to the binding nature of the arbitration. States may thus chose that the arbitrators' decision "shall not be implemented" if the competent authorities agree on a different resolution within three months of the arbitrators' decision. This opt-out may be in relation to all arbitrations or only in relation to so-called principled arbitrations.

Type of Arbitration Process

The BEPS Convention adopts last best offer ("baseball arbitration") as the default procedure. An optional principled procedure may be adopted instead. This is an all-or-nothing choice. Although the principled procedure requires a decision based on the law as applied to the facts, the competent authorities must agree on any legal sources other than the relevant treaty and the domestic law of the two states. Where the choices made by two states are not identical, then there is no arbitration provision in place between them unless the competent authorities agree on the type of arbitration process.

Measuring success

It is often said that the success of mandatory binding MAP arbitration is not so much in generating arbitrations but in the pressure it puts competent authorities to resolve their differences quickly and before entitlement to invoke arbitration arises.

The drafters of the BEPS Convention arbitration provisions have done much to relieve that pressure on the competent authorities. Firstly the two year time limit for resolution by agreement may be extended to three years. Secondly, detailed rules about the sufficiency of information provided by taxpayers allow for the extension of the time limit until information requested by a competent authority is provided. Thirdly, competent authorities may ignore the arbitrators' decision if the can agree a different resolution.

All the other substantive provisions of the BEPS Convention, have been the subject of several discussion drafts published for comment by the OECD. The arbitration provisions first saw the light of day when the draft Convention was published. There has been no public consultation on the text contained in the draft. Some of the provisions may address concerns of tax administrations about the process and governments reluctant to agree to arbitration. Independent input on the viability of the provisions to address the basic drivers behind submitting international tax disputes

to an independent panel are notably absent.

Apart from the primary decision by states whether to apply the arbitration provisions of Part IV of the BEPS Convention, there are at least 10 choices that states may make within it. If all 20 states that have shown interest in mandatory binding arbitration adopt Part IV, it will take some time to see whether workable arbitration mechanisms emerge between any two contracting states. This poor camel may find itself put out to pasture even before it has had a chance to see if it can bear the load its was designed to carry.

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