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Tax certainty: Cure the disease not the symptom

Jonathan Schwarz (Temple Tax Chambers; King's College London) · Tuesday, August 28th, 2018

The update on tax certainty *IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors* published on 22 July 2018 may not have been everyone's summer holiday reading. This report follows on from the 2017 *IMF/OECD Report for the G20 Finance Ministers* in March 2017. It should certainly give pause for thought. The "tax certainty agenda" was launched through the G20 Leaders, Hangzhou Summit Communique in September 2016 which referred to "the benefits of tax certainty to promote investment and trade" and asked the OECD and IMF to continue working on the issue. This was followed by the OECD business survey on tax certainty in October 2016 that provided some of the groundwork for the reports.

Law should be certain

As a lawyer, one striking aspect of the reports is that "tax certainty" as expressed in the IMF/OECD reports, appears to be very different from legal certainty. To the lawyer, legal certainty is an essential aspect of the rule of law. UK Supreme Court judge, Lord Mance, said in opening his Oxford Shrieval lecture on 11 October 2011 "The law should be certain, so that it can be easily enforced and so that people can know where they stand. We expect it in our relations with authority, and in our relations with each other."

No doubt the authors of the reports would not disagree with this. The reports do not however offer any definition of tax uncertainty except to the extent that it may be gathered from the sources of uncertainty listed in the reports. The authors identify six main categories of sources of tax uncertainty:

- Policy design and legislative uncertainty
- Policy implementation and administrative uncertainty
- Uncertainty around dispute resolution mechanisms
- Uncertainty arising from changes in business and technology
- Taxpayer conduct can contribute significantly to uncertainty

A more effective framing of the issues would be by reference to the rule of law:

Legal certainty

Two requirements of the rule of law are:

1. Law must be accessible, clear and predictable.

2. Questions of legal rights should be resolved by the law and not the exercise of discretion.[1]

The report downplays the fact that it is the BEPS project itself that is the source of uncertainty. New law always brings uncertainty. Usually, it is only when new rules are applied in practice, that the issues around their meaning and application surface. The scope of the 15 BEPS actions and the urgency of their implementation mean that questions will be raised on many new issues at the same time. Adoption of BEPS related measures globally also multiplies the occasions when such questions will be raised and increases the risk of differing views, even assuming states uniformly implement the legislative recommendations.

This outcome was understood by the OECD at the outset of the BEPS project. In introducing Action 14, the OECD said, “The actions to counter BEPS must be complemented with actions that ensure certainty and predictability for business.” [Action Plan on Base Erosion and Profit Shifting](#), page 23. The fact that Action 14 aimed to make dispute resolution mechanisms more effective, was in recognition of the fact that the BEPS project, as a whole, would generate disputes.

In addition to the uncertainty inherent in new law, BEPS measures have introduced provisions that are deliberately uncertain. The clearest example is Article 4(3) of the OECD and UN Model treaties which replaces the “place of effective management” tie-breaker for resolving dual residence for persons other than individuals with administrative resolution, no clear rules and a draconian outcome where competent authorities do not agree.

In other cases, fuzzy thinking has led to fuzzy concepts that create new uncertainty. Take the case of the meaning of “intangible” under the 2017 OECD Transfer Pricing Guidelines:

“6.6 In these Guidelines, therefore, the word “intangible” is intended to address something which is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances. Rather than focusing on accounting or legal definitions, the thrust of a transfer pricing analysis in a case involving intangibles should be the determination of the conditions that would be agreed upon between independent parties for a comparable transaction.”

Clarity and predictability of laws are at the heart of legal certainty, but are not a feature of these rules.

The 2017 Report’s, at best, ambivalent, approach to retrospective legislation misses the fundamental element that law must be certain at the time when a citizen is to act by reference to it.

Sound administration

In public law, there is “a requirement of good administration, by which public bodies ought to deal straightforwardly and consistently with the public”: *R (Nadarajah and Abdi) v Secretary of State for the Home Department* [2005] EWCA Civ 1363, per Laws LJ.[2] This fundamental right is enshrined in article 41(2)(a) of the Charter of Fundamental Rights of the EU. Taxpayers and tax administrations have a common interest in tax assessment and collection being handled impartially, fairly and within a reasonable time.

The BEPS project does not address this issue other than insofar as Action 5 (exchange of information on rulings) and Action 13 (country-by country reporting) may improve tax

assessment. Dealing with the BEPS outputs increases pressure on under-resourced tax administrations. The volume of new law is a challenge even for administrations that are not capacity constrained – the OECD Transfer Pricing Guidelines have doubled in size to 612 pages since 2010; the UN Transfer Pricing Manual is up to 668 pages from 499 in 2016; the Condensed OECD Model Treaty and Commentary has grown by a third since 2014 to 658 pages with the UN Model now 836 pages, up by 35% from 2011. The MLI adds another 48 pages (ignoring country positions) and CBCR Guidance 30 pages. Any domestic law giving effect to other BEPS actions must be added to the list.

The task of delivering sound administration of the new international tax regime will more likely be delivered if the issues related to it are seen as such, and not conflated with certainty. Uncertainty in the sense that outcomes are unknown for longer than they should, is a by-product of the lack of sound administration. Cure the disease not a symptom!

Just and equitable resolution of disputes

Where the parties cannot resolve disputes themselves, the rule of law requires access to justice, and fair court and tribunal processes. Every dispute resolution process, no matter how efficient is time-consuming and expensive. Prevention is only by legal certainty and sound administration. Again, uncertainty during the process is a by-product, not the problem. Conflating the disease with the symptom risks missing the cure.

BEPS Action 14 is a real step in the right direction by making the MAP process a minimum standard and by encouraging arbitration of unresolved disputes. Progress in this area would be made by express recognition that treaty based mutual agreement procedure is nothing more than the legal framework for parties to the dispute to resolve the issues themselves (albeit to the exclusion of one party- the taxpayer). It is not itself a dispute resolution mechanism. Adjudicated international tax dispute resolution is in its infancy. Its contribution is to press the parties into timely and fair agreement between the parties.

The only thing that is certain about tax uncertainty is uncertainty itself^[3]. The solution is within the tenets of the rule of law.

[1] Lord (Thomas) Bingham, *the Rule of Law* (Allen Lane, 2010).

[2] Lord Mance, Oxford Shrieval lecture on 11 October 2011, paragraph 4.

[3] (with apologies) “The only thing we have to fear is fear itself.” Franklin D. Roosevelt, First Inaugural Address, 4 March 1933.

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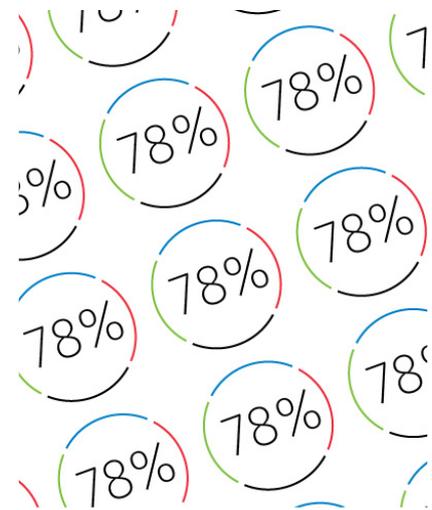
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