taxnotes® international

Volume 93, Number 8 ■ February 25, 2019

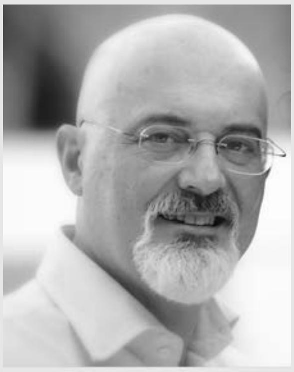
Resolving Cross-Border Tax Disputes: Developments in the EU and Around the Globe

by Piergiorgio Valente

Reprinted from *Tax Notes International*, February 25, 2019, p. 845

Resolving Cross-Border Tax Disputes: Developments in the EU and Around the Globe

by Piergiorgio Valente



Piergiorgio Valente

Piergiorgio Valente is the president of the CFE Tax Advisers Europe and a professor of EU tax law and tax and financial planning at the Link Campus University in Rome.

In this article, the author examines recent changes to international tax dispute mechanisms, including the mutual agreement procedure and arbitration, from the perspective of the EU and the OECD. He comments on similarities and differences in the European and international frameworks in an era of increasing globalization.

Cross-border dispute resolution mechanisms have been evolving rapidly in recent years. The importance of an effective process for enforcing bilateral double tax agreements and for avoiding double tax issues more generally cannot be understated. Two critical tools in this regard are the mutual agreement procedure and arbitration.

The final report on action 14 of the OECD's base erosion and profit-shifting project focuses on the improvement of tax dispute resolution. Along with the changes that the multilateral instrument makes to article 25(5) of the model convention, the OECD's work is inspiring international change. Meanwhile, at the EU level, the new tax dispute resolution directive (2017/1852) is a more forceful tool than the EU arbitration convention (Convention 90/436/EEC), which is a key element of the existing EU tax dispute resolution network. The similarities and differences in these two mechanisms are worth examining, particularly as we proceed toward a global economy and connected world.

This article will provide a comprehensive outline of the changes that have been made to the MAP and the cross-border dispute resolution framework more generally at international and EU levels. Section II focuses on the measures that the members of the BEPS inclusive framework have agreed to, including the relevant provisions in the MLI. Section III centers on the new EU directive and the changes it brings to the single market. Section IV concludes with some remarks regarding the points of difference and convergence between the EU legislation and the OECD's international approach and the importance of consistency in a global society.

I. General Framework of the MAP

The MAP is a mechanism for the resolution of cross-border tax disputes arising, in principle, in connection with a DTA. It is also available under the EU arbitration convention, although the arbitration convention only applies to transfer pricing disputes between EU member states that are signatories to that agreement. Initiated by a taxpayer's request, the MAP aims to resolve disputes through an agreement between the relevant national tax authorities based on dialogue and cooperation.

The MAP exists to promote the effective application of DTAs. It seeks to guarantee that the contracting states respect the agreed-upon provisions, perform the obligations they have undertaken, and thus ensure that taxpayers actually enjoy their respective rights. Thus, the MAP contributes to ensuring that DTAs effectively prevent double taxation — as well as double nontaxation — and subsequently promote cross-border investment.

From the taxpayers' perspective, the MAP is a tool they can use to pursue their rights under the DTA if they believe those rights have been violated or might be violated in the future. In such a case, absent the MAP, taxpayers could pursue available domestic tools including settlement or litigation. The difference and the advantage of the MAP lies with its international element: If the taxpayer concludes that the conduct of one state deprives it of its rights under a specific DTA, it can opt to include the other contracting state in the dispute.

In practice, the taxpayer files its complaint with the national tax authority of one of the states involved and requests that the state consult with the competent authority of the other state to find a common solution in compliance with the DTA provisions. Depending on the wording of the specific DTA provision, the taxpayer may have to submit its complaint with the tax authority in its country of residence, or the taxpayer may be entitled to choose to submit the complaint with either of the states involved or even with both.

The state that receives the complaint must proceed with a consultation if the complaint fulfills specified conditions — namely, that the state cannot provide a satisfactory solution unilaterally and considers the complaint justified. If the agreement only allows the taxpayer to complain to one of the contracting states and the state that receives the complaint does not consider it justified, then that state may reject the taxpayer's request for a MAP and the taxpayer can only appeal that rejection at the domestic level.

Once the first state puts the consultation forward, each contracting state must give an account of its conduct to its contractual counterparty. Therefore, the taxpayer gains a strong ally — a sovereign state — in the defense of its rights, provided those rights actually exist under the DTA.

Thus, a MAP that functions well and that taxpayers can effectively activate is a precondition to a fair and efficient international tax framework. Remarkably, however, the MAP does not actually imply the elimination of double taxation since, in principle, the states involved in a MAP have no obligation to achieve that result — they are only bound to make best endeavors to this end.

The framework for the MAP has undergone important renovations in the past few years at the international and EU levels. First, the BEPS project — an effort that the OECD launched in 2013 and that has progressively united more than 115 jurisdictions (the inclusive framework) against tax avoidance — addressed the MAP. In particular, it was felt that the legislative amendments brought forward with the BEPS actions could increase disputes as well as uncertainty. Therefore, such actions were complemented with enhanced solutions to resolve uncertainty.

In the same direction, in 2016 the European Commission presented a proposal for a directive to improve cross-border tax dispute resolution in the single market (COM(2016) 686 final). Passed in 2017, the new directive — which member states must transpose into their laws by June 30 — addresses deficiencies identified in the existing EU tax dispute resolution framework, such as the limited scope of the arbitration convention and the limited rights for taxpayers to intervene in the dispute resolution procedure.

II. MAP and BEPS

A. Overview

At the international level, enhancing the MAP and cross-border tax dispute resolution as a whole is the topic of action 14 of the BEPS project. The purpose was to:

> develop solutions to address obstacles that prevent countries from (re)solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.

The action plan gave priority to cutting the length of the procedures and ensuring that disputes are resolved in a timely fashion — especially given the lack of an obligation for the states to reach a resolution.

To this effect, the final report includes the agreement of the members of the inclusive framework on:

- minimum standard actions, which are measures that all members agreed to enact without delay;

- continuous monitoring of each state's practices and progress relevant to the minimum standard actions; and
- specific best practices that states can implement at their discretion that are not subject to monitoring.

Also, the report promotes the use of mandatory binding MAP arbitration with the commitment of countries that were engaged in more than 90 percent of the tax disputes pending at the time of the report to adopt the tool. Through the MLI, the drafters developed amendments to the relevant provision of the OECD model convention (that is, article 25(5)) and the related commentary.[1]

B. The Minimum Standard

The underlying objective of the minimum standard has been to ensure that taxpayers have an effective right to pursue dispute resolution through the MAP — that is, ensuring that states do not reject their complaints unreasonably and that the procedure is not unreasonably lengthy. Another objective has been to ensure that national tax administration procedures favor the prevention of disputes by, for example, adopting clear and undisputable rules.

The plan divided the actions stemming from the minimum standard into three categories according to the specific objectives they pursued:

- actions to ensure that members fully and in good faith implement the MAP obligations in their DTAs and promote the timely resolution of disputes;
- actions to ensure that tax administrations promote both the prevention of disputes and the timely resolution of DTA-related disputes; and
- actions to ensure that eligible taxpayers have actual access to the MAP for appropriate matters.

In more detail, under the first category, states agreed to ensure that the MAP functions as a dispute resolution procedure independent from domestic remedies and audit procedures. They also agreed that the scope of the MAP should always include transfer pricing questions and doubts regarding the application of antiabuse legislation. This is notable because the antiabuse laws might otherwise prevent the taxpayer from accessing benefits under a specific DTA — including the MAP. The states also confirmed the importance of timely resolution to the efficacy of the right to access the MAP and confirmed their intention — albeit not their commitment — to try to conclude MAP disputes within, on average, 24 months. The OECD recognized that the potential for mandatory MAP arbitration and the states' commitment to transparency regarding their respective approaches to the MAP are both useful tools that can help promote effective dispute resolution.

Notably, based on a footnote in the 2014 version of the OECD model convention, the rules did not require transparency pre-BEPS, a policy that underlined the states' freedom to adopt or not adopt MAP arbitration in their DTAs without explanation. The newer version of the model does not include such a footnote. Further, action 14 directs the national tax authorities to develop stronger cooperation with each other. To this end, the states committed to becoming members of the Forum on Tax Administration's MAP Forum. Established in 2002, the Forum on Tax Administration[2] is a subsidiary of the OECD Committee on Fiscal Affairs. It has 53 members, including both OECD and non-OECD jurisdictions. The forum's goals include the collective improvement of national tax administration, the promotion of a service-oriented approach to tax administration, and, ultimately, an increase in tax compliance.

The second category of minimum standard actions focuses on improving internal tax administration procedures relevant to the MAP, which includes promoting the transparency of the processes and ensuring the potential for proactive prevention of tax disputes. To this end, the members of the inclusive framework agreed that tax authorities must make clear guidance regarding the MAP process available so that taxpayers are aware of all requirements and the

[1] Piergiorgio Valente, "BEPS Action 15: Release of Multilateral Instrument," 45 *Intertax* 3 (2017).

[2] OECD, "About — Forum on Tax Administration" (accessed Feb. 7, 2019).

steps in the process. The OECD published a document titled "Guidance on Specific Information and Documentation Required to be Submitted With a Request for MAP Assistance"[3] to assist states in drafting this guidance and promote worldwide consistency regarding the requirements for an admissible MAP request. To ensure that taxpayers are duly informed, the rules provide that all countries' MAP profiles will be uploaded on a public platform. Furthermore, the minimum standard includes protecting the independent judgment of the competent authority. Therefore, beyond ensuring there is adequate funding for relevant functions, assessments of a tax authority's dispute resolution performance should focus on timely, effective, and consistent resolution of disputes — not factors like the tax revenue sustained. To reduce the number of disputes and improve their management, the members agreed to put proactive measures in place, which includes providing for the rollback of bilateral advance pricing agreements when appropriate — that is, allowing the APA to apply to previous tax years when the issues that the APA resolves are relevant to those years.

As for the third category of minimum standard requirements, states should enhance taxpayers' access to the MAP by ensuring that the tax authorities in both contracting states receive notification of the dispute and both have adequate information to allow them to form their position. Therefore, following the BEPS project, either the rules should allow taxpayers to address a MAP request to either of the contracting states' authorities or they should provide for a consultation process between the two authorities. This ensures that a single authority cannot prejudice MAP dispute resolution by its own inaction or by acting unreasonably. Moreover, since implementing a MAP decision is a core element of effective resolution, states should ensure that domestic time limits will not prevent the implementation of MAP decisions.

C. Monitoring the Minimum Standard

All of the foregoing measures are part of the minimum standard that the members of the inclusive framework agreed to enact in order to improve the MAP. They are evidence that shared risks can stimulate broad cooperation at the international level. Yet as part of the BEPS project, the inclusive framework members took a step forward that may be even more important: They agreed to have their relevant processes and practical conduct monitored through peer review with the results made public. To enable this review, the states committed to regularly provide information and statistics about their internal practices related to the minimum standard. The process also invites and considers feedback from other stakeholders.

The terms of reference and the assessment method documents provide rules for the MAP peer review process.[4] The terms of reference set out the factors against which the reviewers will assess the legal regime and actual practices of each member of the inclusive framework. These factors refer to:

- the potential to prevent tax disputes (for example, the use of bilateral APAs and clarity of legislation);
- the availability of the MAP for a broad range of disputes and taxpayers' effective right to access it;
- the actual resolution of MAP disputes consistently and promptly; and
- the effective implementation of all MAP agreements.

The assessment method envisages a two-stage procedure for conducting peer reviews in each jurisdiction. In the first stage, reviewers evaluate a state's legal framework and actual practices involving the MAP against the aforementioned factors. The first stage concludes with the issuance of recommendations for steps the jurisdiction should take to remedy any identified deficiencies. The second stage assesses the jurisdiction's implementation of these recommendations.

[3] OECD, "BEPS Action 14 on More Effective Dispute Resolution Mechanisms: Peer Review Documents," at 57 (Oct. 2016).

[4] *Id.*

D. Best Practices

Beyond the minimum standard, the final report on action 14 includes additional steps to improve the MAP framework that it characterizes as best practices. The OECD recommends that states adopt best practices but does not consider them indispensable at this stage; consequently, the states' progress is not monitored.

For example, the report encourages states to enact bilateral APA programs and provide relevant guidance on APAs, including unilateral, bilateral, and multilateral APAs. The OECD also encourages jurisdictions to make the agreements reached in the context of the MAP public when publication could help clarify open issues for other taxpayers as well. To the same effect, states are encouraged to work to enhance the global awareness of the MAP-related functions of the national tax administration. Global awareness includes ensuring that relevant staff members are able to assess the implications of their conduct from a global perspective.

E. Mandatory MAP Arbitration

The action 14 final report encourages states to adopt mandatory binding MAP arbitration in their DTAs, a concept that has been included in article 25(5) of the OECD model convention since 2008. Mandatory arbitration would complement the MAP, permitting taxpayers to request and provoke the resolution of tax disputes submitted to the MAP by an independent authority under specified conditions, including the failure to resolve a MAP within two years. This addresses a key deficiency of the MAP procedure as it currently stands — it does not necessarily lead to dispute resolution. National tax administrations involved in a MAP must make their best endeavors to resolve a tax dispute, but no more than that: They are under no obligation to reach a resolution of the case. The reason is that, in principle, states are reluctant to commit to abide by a decision of an independent third party as that obligation would imply a severe restriction of state sovereignty.

However, uncertainty regarding the ability to resolve tax disputes and lengthy dispute procedures are a disincentive to investment and growth. Also, mandatory arbitration seems to be the only solution that would ensure that cross-border tax disputes are resolved promptly. Therefore, 20 states have committed to adopt such clauses in their DTAs — amending the existing provisions using the relevant clause in the MLI and referencing the respective provision of the OECD model convention in future DTAs.[5] Together, according to the action 14 final report, these 20 states were involved in 90 percent of the pending MAP cases at the end of 2013. The relevant wording in the MLI provides a sample of the procedural structure for arbitration that contracting states may adopt.[6]

III. EU: Tax Dispute Resolution Directive

A. Background

The European Commission first proposed the reform of the EU framework on cross-border tax dispute resolution in October 2016 as part of a comprehensive package to reform corporate taxation in the single market.[7] Apart from enhancing tax dispute resolution, the package provided for (i) the harmonization of member states' legislation on the assessment of the corporate tax base (COM(2016) 685 and COM(2016) 683 final) and (ii) the elimination of hybrid mismatches between legislation of member states and third countries through the extension of the anti-tax-avoidance directive.

One year after the release of the final report on BEPS action 14, the EU's tax dispute resolution proposal attempted to adopt the BEPS recommendations in a harmonized manner across the single market. While the same objectives underpinned both efforts — that is, to improve the fairness, efficiency, and legal certainty of taxes — the EU's proposal was also motivated by the special features of the single market: a union of 28 different regulatory regimes between which people and capital can move freely. If the member states took different approaches to implementing the BEPS recommendations, it might increase the preexisting uncertainty in EU taxation and

---

[5] The 20 states 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.

[6] Valente, *supra* note 1.

[7] European Commission, "Commission Proposes Major Corporate Tax Reform for the EU," IP/16/3471 (Oct. 25, 2016).

undermine the competitiveness of the single market as an investment destination.

B. The Existing Framework in the EU

Today, the DTAs signed by the member states and the EU arbitration convention govern the resolution of tax-related disputes between member states. The member states signed the convention in 1990 to come into effect in 1995 for an initial five-year period, which they later extended through a 1999 protocol. The impetus behind the arbitration convention was an ambitious proposal brought forward in 1976 for a directive to eliminate double taxation in transfer pricing cases in the EU. After years of fruitless negotiations, largely because of the aforementioned states' reluctance to adopt arbitration, the proponents dropped the idea of a directive in favor of a convention as the sole, practically feasible solution.

While the DTAs are generally based on the OECD model, the arbitration convention addresses a limited scope of disputes and it prevails over the respective DTAs when disputes within its scope arise between signatory member states. Specifically, it applies to transfer pricing disputes when a member state makes an upward adjustment of an enterprise's taxable profit and another member state has already taxed that profit as part of the taxable base of a related company or permanent establishment. It follows that the arbitration convention only applies to multinational enterprises: It does not apply to individuals, purely domestic businesses, or multinationals with activities outside the EU but in only one member state. Its purpose has been to ensure that double taxation is effectively eliminated for this type of issue by introducing an obligation to reach an agreement when the states receive complaints in the context of a MAP.[8]

Although the arbitration convention marked a positive step forward for business taxation in the single market, in practice, the convention has some important shortcomings. Its restricted scope means that all disputes outside its coverage may only be resolved using the MAP provision in the applicable DTA, assuming the dispute falls under the DTA's scope. In that case, in principle, member states are not bound to eliminate double taxation — as above, they are only bound to make their best endeavors to find an agreement to that effect.

For disputes that are within the convention's scope, while the taxpayer's request sets things in motion, all necessary actions are under the full control of national competent authorities. If they do not act for any reason, the taxpayer cannot intervene to pursue his rights.

Furthermore, the arbitration convention does not provide a clear and comprehensive procedural time frame, leading to uncertainty regarding the timeliness of the dispute resolution.

C. The New Framework

The European Council finally adopted the proposal for a directive, which recalls the original purposes behind the arbitration convention and seeks to address its shortcomings, in October 2017.[9] The new framework will begin to apply July 1, 2019, to disputes involving tax years from 2018 and onward.

Although the council generally tailored the directive in line with the BEPS recommendations, it offers some improvements including measures to address the needs of specific categories of taxpayers (for example, small and medium-size enterprises) and to maximize the flexibility of tax dispute resolution. Thus, as Section IV of this article notes, the arbitration procedure that the directive envisions is not identical to the procedure the MLI describes as part of the BEPS project. For cost-efficiency purposes, the new framework expands existing mechanisms rather than introducing entirely new ones.

In particular, the directive has a wide scope, extending to all potential questions of interpretation and application involving DTAs or other tax-related agreements between member states, including the arbitration convention. All taxpayers — including individuals and SMEs — can invoke the directive, and taxpayers are also

[8] The interpretation and application of the arbitration convention is clarified and detailed in EU Council, "Revised Code of Conduct for the Effective Implementation of the Convention on the Elimination of Double Taxation in Connection With the Adjustment of Profits of Associated Enterprises," 2009/C 322/01 (Dec. 30, 2009).

[9] Valente, "Tax Dispute Resolution Directive: An Important Step for the EU," Kluwer International Tax Blog (Oct. 31, 2017).

given effective means to pressure member states to take the necessary steps to put the mandatory dispute resolution mechanism in place. If the member state does not take proper steps in accordance with the directive, the taxpayer can request that the national courts replace the national tax authorities and take effective steps. Moreover, taxpayers can trust that tax dispute resolution will be timely and, hence, effective — generally within 18 months according to the strict procedural timeline in the new framework.

As to other shortcomings that the new rules seek to improve upon, the provision for the publication of decisions (or part thereof) enhances legal certainty. Publication is subject to the consent of the national authorities and taxpayers involved. Absent consent, decisions can be published as abstracts. The new rules also try to make the taxpayers' burden in the dispute resolution process proportionate to their size and the needs of the specific dispute, including favorable provisions for individuals and small enterprises. Finally, the directive favors flexibility by encouraging states to use alternative dispute resolution mechanisms, such as mediation or conciliation, while always ensuring the timely issuance of binding decisions eliminating double taxation.

IV. Concluding Remarks

Cross-border tax dispute resolution is increasingly attracting the attention of tax policymakers worldwide as a tool to improve the fairness and efficiency of taxation. Demonstrating this trend, reforming the existing mechanisms has been a key objective for both the OECD and the inclusive framework as well as for the EU. The reforms envisaged seek to address identified impediments to the effective resolution of tax-related disputes, including the double taxation and double nontaxation phenomena.

The targeted impediments could be considered remnants of a world constructed on the concept of state sovereignty, on territoriality. Single sovereign states negotiating and contracting independently have always sought to protect their sovereignty and have therefore avoided getting involved in procedures that might bind them independently from their will. The traditional concepts of sovereignty and territoriality, however, are now being overcome in a world that is progressing toward a unified global market and the unlimited universe of cyberspace.[10]

Without the certainty of territorial boundaries ring-fencing states' tax jurisdiction and amid the continuous, high-speed digitalization of the economy, states seem to have no alternative but to concede some of their power in favor of globalized institutions — at least if they wish to maintain some of their regulatory power over the economy.

Across the board — namely, at both the international (OECD) and the EU levels — the new measures seem to have enhanced cross-border tax dispute resolution mechanisms and promise more effective proceedings in the future. Yet comparing the measures that the OECD recommended in the BEPS project with the new EU directive suggests that the latter may offer stronger, more concrete rules than the former. First, the directive grants taxpayers an effective right to intervene in the dispute resolution proceedings by referring to national courts if lack of action by the competent authorities causes delay.[11] This opportunity for intervention enhances taxpayers' engagement with the process. Second, the directive enhances transparency and subsequent tax certainty in the single market by envisaging publication — even in part — of the dispute resolution decisions. Third, the directive favors the adoption of tailor-made solutions on a case-by-case basis, encouraging member states to consider mediation and conciliation as alternatives to arbitration.

Furthermore, a comparison of the procedures that the OECD embraces in the final report on BEPS action 14 and in Part IV of the MLI with the process in the EU directive reveals that they are similar, albeit not identical. This is particularly evident in the context of mandatory binding arbitration proceedings following fruitless MAP. In both cases, the rules safeguard the arbitrators'

[10] Valente and Luca Bagetto, *Geofiscalità: Il Dilemma di Giano tra Cifra Tellurica e Continente Digitale* (2017).

[11] Notably, however, the MLI's arbitration procedure also contemplates occasions when the national authorities do not act promptly, authorizing the OECD Centre for Tax Policy and Administration to substitute for the authorities in those cases. *See* article 20 of the MLI.

independence and the confidentiality of the proceedings. Likewise, the states involved in the dispute are always free to agree to different rules for the arbitral proceedings as best suits the specific case. But the arbitration panel is composed differently in each regime, consisting of three members under MLI article 20(2)(a) and five members under article 8(1) of the directive. Also, article 23 of the MLI favors best offer or so-called baseball arbitration while article 15 of the directive provides for the states to submit position papers but has the arbitrators formulate the decision. Although the differences are slight, the fragmentation risks undermining the certainty of the international tax framework.

Cross-border tax dispute resolution is likely to become more effective and timelier soon, a trend with positive implications for economic development and growth at the global level. In this area, the new EU directive goes further than the corresponding BEPS framework and could inspire the OECD's enhancement of its framework in the future. At the same time, the EU's directive deviates from the BEPS framework in a manner that could imply fragmentation of international taxation. While the instances of fragmentation are only slight and thus cannot be deemed to constitute a risk in and of themselves, it is important to avoid fragmentation in taxation, especially in an era of increasing globalization. ■