

OECD work on the resolution of international tax disputes

2012

Marlies de Ruiter and Edward Barret discuss Article 25 (Mutual Agreement Procedure) of the OECD Model, which provides a mechanism for the resolution of international tax disputes

The globalisation of international trade and investment has created a world in which cross-border flows of goods, services, capital and technology have taken on enormous importance. In 2011, world merchandise trade was valued at USD 18.2 trillion and world commercial services exports were valued at USD 4.2 trillion¹. Total foreign direct investment positions were also recently reported to total USD 20.7 trillion in 2010².

Given the significance of these cross-border flows, there is a great deal at stake for governments as they seek to tax the income and gains these flows produce. This stake for governments is even more prominent in the current economic climate, where the worldwide economic crisis and the consequential rise of government debts spur the need to protect tax bases and make sure that all taxpayers contribute their fair share of tax.

In many cases, the provisions of a tax treaty based on the OECD Model Tax Convention (the OECD Model) or the United Nations Model Double Taxation Convention between Developed and Developing Countries (the UN Model) will limit the taxation of gains or income to make sure that taxpayers are not confronted with double taxation.

International tax disputes may arise, however, when there are disagreements between countries as to how a tax treaty should be interpreted or applied to specific international transactions or activities, or when a taxpayer considers that it has been subject to taxation contrary to the terms of a tax treaty. International tax disputes most frequently arise in the area of transfer pricing, where the issues involved are complex and the amounts at issue may be huge and may therefore lead to enormous costs for the taxpayers involved.

Article 25 (Mutual Agreement Procedure) of the OECD Model provides a mechanism for the resolution of such international tax disputes. Under Article 25, a taxpayer may present its case to the competent authority of its country of residence when it considers that it has been subject to taxation not in accordance with the provisions of the treaty. That competent authority is then obliged to endeavour to resolve the case by mutual agreement with the compe-

tent authority of its treaty partner, and the agreement so reached will be implemented notwithstanding any time limits in the domestic law of the two countries.

Whilst the mutual agreement procedure (MAP) provides a generally effective and efficient method of resolving international tax disputes, statistics for OECD member countries³ show that there has been a steady increase in MAP caseloads over the last five years: OECD member country end-of-year inventory increased from 2,352 cases in 2006 to 3,328 cases in 2010, a rise of more than 40%.

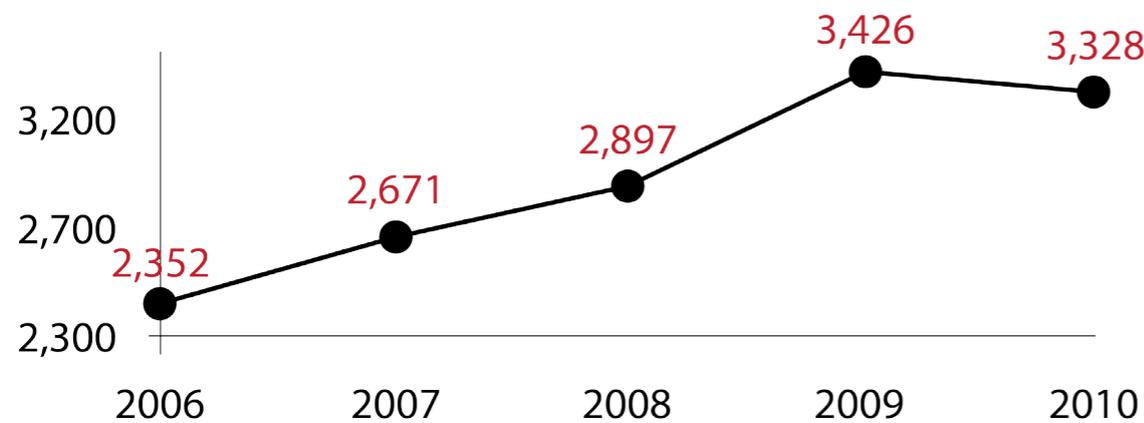
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These statistics also indicate that over the same period the average number of months needed to resolve a MAP case had increased to 27.3 months in 2010 (from 22.1 months in 2006). And the caseloads are expected to increase even more, especially since a relevant number of governments have announced their intensified efforts to enforce and audit international tax issues.

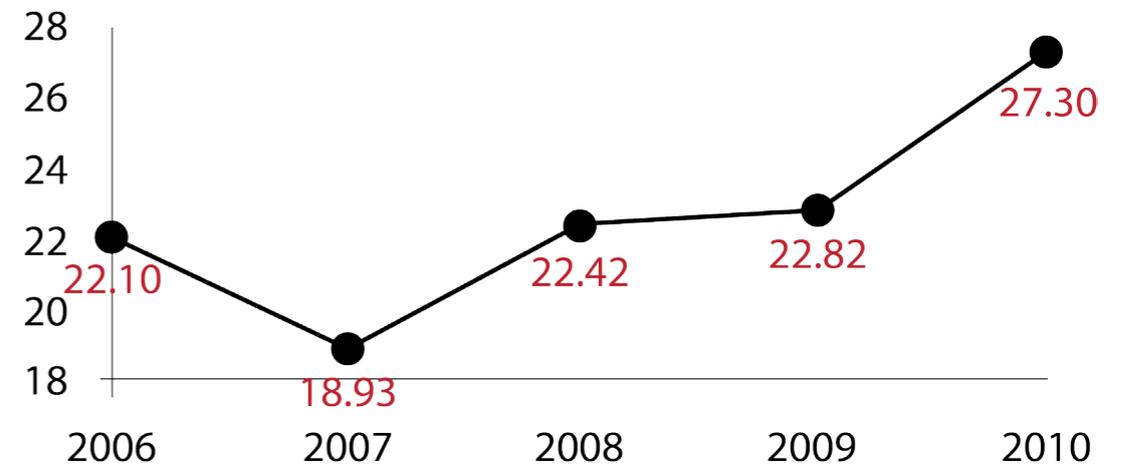
For taxpayers it is very important that the double taxation that arises from these controversies is resolved and that this resolution is achieved as speedily as possible. In the current economic climate, where many businesses and individuals need to economize in order to stay alive, this is even more the case than five years ago. Implementation of

MAP case load of OECD member countries has increased by 41.5% over the last five years

End of year inventories of MAP cases



Number of months to complete a MAP case



the results of OECD work on the resolution of international tax disputes is a key way in which countries can balance the enforcement efforts they undertake with the interests of the taxpayers involved.

Since its 2008 Update, the OECD Model has included a mandatory binding arbitration provision in paragraph 5 of Article 25. Under that provision, where competent authorities are unable to reach agreement in a MAP case within two years, any unresolved issues shall generally be submitted to binding arbitration upon the taxpayer's request.

Arbitration provisions should be expected to increase the timeliness of the MAP procedure and reduce case inventories, but OECD member countries have continued to show a certain hesitance in adopting arbitration provisions. In fact, since 2005⁴, only 17% of the treaties and protocols concluded by OECD member countries have included arbitration provisions. In this regard, it is significant to note that Article 25 of the 2011 Update of the UN Model⁵ includes an optional arbitration provision (which contains certain differences with respect to the OECD provision intended to respond to the particular interests of developing countries and countries in transition).

The OECD is exploring how to encourage the wider use of arbitration, such as by monitoring the adoption and implementation of arbitration provisions, identifying barriers to adopting arbitration and/or the sharing of country experience with respect to design and practical implementation.

In 2007, the OECD presented its Manual on Effective Mutual Agreement Procedures (MEMAP)⁶, a guide intended to increase awareness of the MAP process and how it should function. Developed by a working group of OECD member country competent authority officials based on their practical experience with the MAP, the MEMAP provides tax administrations and taxpayers with basic information on the operation of the MAP.

The MEMAP recommends 25 non-binding best practices to deal with particularities of the MAP process or procedural issues. At a roundtable organised by the OECD in January of this year, business representatives indicated that

these best practices are often not adopted by competent authorities, leaving taxpayers to bear double taxation in cases that should be covered by the bilateral tax treaties. At a time when taxpayers are demanded to pay a fair share, it is also important that competent authorities show their willingness to resolve the controversies that lead to taxpayers paying more than their fair share.

On the fifth anniversary of the MEMAP, it may be a good time to evaluate whether the MEMAP is a mechanism that stimulates the implementation of swift and effective dispute resolution processes by governments or whether the mechanism should be changed, expanded or replaced in order to encourage governments to implement dispute resolution processes that are fit for purpose in a time when rising caseloads of international tax disputes are expected. ■

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Endnotes

1. See World Trade Organization, "World trade figures for 2011, prospects for 2012", PRESS/658/Rev.1 (press release dated 10 May 2012)

(available at: http://www.wto.org/english/news_e/pres12_e/pr658_e.pdf).

2. See International Monetary Fund, "IMF Releases Results from its 2010 Coordinated Direct Investment Survey", Press Release No. 11/479 (dated December 20, 2011) (reporting the release of the results of the IMF's 2010 Coordinated Direct In-

vestment Survey) (available at: <http://www.imf.org/external/np/sec/pr/2011/pr11479.htm>).

3. MAP statistics for OECD member countries and certain non-OECD economies are available on the OECD website at: <http://www.oecd.org/ctp/dispute/map-statistics-2006-2013.htm>

4. The OECD arbitration provision was first presented in draft form in 2005.

5. See paragraph 5 of Article 25 (alternative B) of the 2011 UN Model (available at: http://www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf).

6. Available at: <http://www.oecd.org/tax/dispute/manualoneffectivemutualagreementproceduresmemap.htm> or <http://www.oecd.org/dataoecd/19/35/38061910.pdf>