Proposals to improve the efficiency of the MAP

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discuss the issues arising from the application of the MAP.

Having an efficient alternative dispute resolution mechanism is key for purposes of reaching the aim of double tax conventions, i.e. elimination of double taxation without creating opportunities for non-taxation or reduce taxation through tax evasion or avoidance.

Although the mutual agreement procedure (MAP) has proved its efficiency as an alternative dispute resolution mechanism for resolving international tax disputes, it has also proved its fragility and limitations.

This article analyses the problems that arise from the application of the MAP and present proposals to improve the efficiency of MAP to resolve controversies under double tax agreements.

Introductory remarks

Alternative dispute resolution mechanisms enable tax administrations to reach solutions on issues relating to double taxation, general interpretation, or application of double tax conventions by (generally) allowing experts on international tax law to resolve disputes on cross-border transactions.

In general, some countries might not desire to give part of their revenue and oblige themselves to enforce certain awards or agreements that do not necessarily benefit them. In some cases, this situation may be presented as granting part of their sovereignty while in others, constitutional constrains might be present to implement the conclusive agreement or award borne by a dispute resolution mechanism.

In that regard, some states would prefer to resolve cases through a procedure similar to MAP (where they do not grant part of their sovereignty to another state or third party) instead of entering into a procedure whereby a third party would evaluate and provide a solution to the case. Notwithstanding, the MAP has been a useful tool for both, taxpayers and tax authorities to redeem cross-border disputes on tax matters, it has also taught us that it is not sufficient as it is today in a

globalised world where the number of international tax controversies keeps increasing.

The BEPS project has served to analyse and comprehend many international tax issues that tax administrations should bear in mind. Thus, the importance of having appropriate dispute resolution mechanisms to redeem tax controversies was noted during the BEPS project. However, the conclusions were not as expected. Although the multilateral instrument (MLI) has been signed by many jurisdictions, it has not been entered into by many of those jurisdictions. Moreover, the peer review albeit seems like a tool that would encourage competent authorities to avoid certain behaviours or implement policy guidelines, in practice, it has not always had the desired effect.

This article does not intend to criticise the efforts made through the BEPS project but aims to follow-up on how to improve the dispute resolution mechanisms available for the taxpayers who are in the position of finding themselves in a situation that goes against the object of double tax treaties.

Problems arising from the application of the MAP

The MAP generally starts with the filing of the objections a taxpayer has in connection to an action that he considers that result or will result in double taxation (not in accordance with the provisions of the Convention). The competent authority of either contracting state should, in principle, receive the claim of the taxpayer.

Notwithstanding, the competent authority should analyse whether the objection is justified, and if it appears to be justified, it should endeavour to resolve the MAP with the other competent authority, for purposes of resolving a double taxation situation arising from the misapplication of the double tax convention by either contracting state.

A vast variety of issues may arise in the context of MAP, which may run from formalities dealing with the time limit for submitting the case, to cases which may involve complex double economic taxation, as to whether certain cases can be subject to the MAP procedure.

In connection to the above, it must be pointed out that according to the Vienna Convention of the Law of Treaties (VCLT), treaties should be interpreted in good faith, in accordance with the ordinary meaning to be given to the terms of the treaty, in the context and in the light of its object and purpose.

Having said that, under the OECD Model Tax Convention the time limit for submission of a MAP is set in three years from the first notification of the action resulting in taxation not in accordance with provisions of the convention. In accordance with the Commentary to the OECD Model Tax Convention contained in paragraphs 20 and 21 to Article 25 (MAP), this rule aims to protect administrations against late objections, whereby it must be regarded as a minimum, and should be interpreted in the most favourable way to the taxpayer, so that contracting states are left free to agree in their bilateral conventions a longer period in the taxpayers' interest.

Apropos of the covered matters of the MAP, paragraph 10 to Article 25 (MAP) of the Commentary of the OECD Model Tax Convention provides machinery to enable competent authorities to consult with each other with a view to resolving, in the context of transfer pricing (TP) problems, not only problems of juridical double taxation but also those of economic double taxation.

Below we will refer to other situations and or issues where there is room for improvement of the MAP, which is the purpose of this article.

Delay reaching an agreement

During the MAP process, competent authorities communicate with each other directly. It is not clearly defined the way or mechanism through which tax authorities should communicate. However, the purpose of having an open channel of communication is avoiding formalisms, accelerate the processes and facilitate competent authorities reaching an agreement.

The competent authorities of the contracting states involved in an international tax dispute should endeavour to resolve by mutual agreement the objection filed by the taxpayer (i) to avoid double taxation situations; and (ii) to

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any difficulties or doubts arising as to the interpretation or application of the convention.

In our view, one of the main issues of the MAP is the scope of the term '*endeavour*' contained in paragraphs 2 and 3 of Article 25 (MAP) of the OECD Model Tax Convention. Both paragraphs foresee that contracting states should 'endeavour' to resolve the MAP. Hence, the said contracting states should *attempt* to reach an agreement; however, they do not have any duty to actually conclude the agreement.

The word endeavour, thus, generates a situation among tax authorities where they do not feel the duty to conclude the agreement, but they should only attempt to reach an agreement, which is considered enough to comply with the terms of the Convention. This situation (among others) may generate delays to taxpayers on finding a solution to their problem.

In this regard, as per the latest statistics of the OECD covering the MAP, over 118 jurisdictions (and practically all MAP cases worldwide), MAP cases on TP matters took over 35 months in 2020 (31 months in 2019), for the rest of the cases the average time that tax authorities took for closing MAPs is 18 months (22 months in 2019).

Due to the COVID-19 pandemic, the communication between tax authorities has been delayed. Although is not possible to estimate the necessary time to close pending cases, the data shows that approximately 15% of the 2020 unresolved cases have been pending for at least five years.

Notwithstanding, the average time MAPs generally take (more than two years as per the OECD recommendation should be the longest) reflect that once MAP is initiated there is a high probability a solution is reached.

However, if this is read *a contrario sensu,* having a high probability to obtain a solution out of the MAP means that *sometimes* tax authorities do not reach a solution on a particular case and in cases whereby and agreement is reached, it is taking longer than the two years it should last.

Then, what happens with these cases? In most cases, taxpayers can request to start an arbitration procedure under Model Tax Conventions if an agreement has not been reached between the competent authorities within two years from the submission of the case.

Nonetheless, the next question that comes up is, what happens with the Double Tax Conventions that do not encompass any arbitration procedure or when arbitration is optional for competent authorities? The answer to this question is simple: taxpayers do not obtain a solution to their case, and this may generate double taxation to them.

As we will elaborate later, in our view to improve its efficiency, the MAP requires a binding arbitration procedure as a secondary procedure rather than a supplementary remedy so that competent authorities prefer to resolve the case through the MAP as opposed to entering a procedure whereby a third party would evaluate and provide a solution to a case.

Concentrated jurisdictions

It should be noted that although taxpayers recognise the problems MAP represents, the number of new cases is still increasing (TP cases have increased almost by 50% since 2016 while the number of other cases has slightly decreased compared to 2019). Apropos of the figures shown in the OECD 2020 statistics, 2500 new cases started in 2020, being a concentrated number of jurisdictions that rely on this process (the top 25 jurisdictions accounting for 25% of the MAP cases and the remaining cases, involving around 40 other jurisdictions).

The fact that most MAPs involve only 25-40 jurisdictions, generate an important gap on the expertise competent authorities develop with respect to the process. Many developing countries consider that they lack expertise on international tax dispute resolution, hence they are not very enthusiastic about the idea of applying any alternative dispute resolution mechanism. Having said that, the idea has been exposed that the contracting states that have more probity in these procedures give trainings and share experiences with the less experienced authorities to close the gap and have a less biased process.

Lack of transparency

In respect to the above, it has been criticised in literature the lack of transparency during the MAP process. Given the informal nature of the MAP, tax authorities normally carry-on the process without communicating with the taxpayers. Furthermore, agreements reached by the competent authorities do not (in some cases) specify the reasoning behind the conclusion of the agreement.

Arbitration procedure

The arbitration mechanism foreseen under paragraph 5 of Article 25 (MAP) of the OECD Model Tax Convention is triggered by the taxpayer when he submits a written request before the competent authorities when they were not able to reach an agreement within the period of two years as per paragraph 2 of Article 25 (MAP).

The scope of the arbitration process is limited to the issues that the competent authorities were not able to resolve.

The arbitration process envisaged under the OECD Model Tax Convention is not an alternative or additional recourse but an extension of the mutual agreement procedure to enhance the effectiveness of that procedure and ensure a solution is given to the case.

Proposal of an efficient alternative dispute resolution mechanism

The MAP has certain weaknesses that due to the informality of this alternative dispute resolution mechanism cannot be filled in. As explained, most of the issues arising from the application of the MAP come from the lack of force this instrument has to oblige tax authorities to obtain a solution.

Although, some tax administrations might argue they do not see with good eyes rendering part of their sovereignty to a third party or to another tax administration, it is paramount for the evolution of the taxpayers' rights, having access to a procedure that warranties (at least) that the taxpayer will obtain a solution to the problem raised to the competent authorities.

A mandatory arbitration procedure allows taxpayer having the certainty a solution will be given to their problem. Moreover, taxpayers will rely on a procedure that would avoid double taxation from the dispute in which they are involved. Likewise, having a mandatory arbitration procedure saves money and time to taxpayers and tax authorities.

Therefore, in our view to improve its efficiency the MAP requires a binding arbitration procedure as a secondary procedure rather than a supplementary remedy so that competent authorities prefer to resolve the case through the MAP as opposed of entering a procedure whereby a third party would evaluate and provide a solution to the case. In other words, this arbitration procedure should work as a preventive or guarding measure so that cases are mainly resolved through a MAP.

Hopefully soon the spread of binding arbitration will become a reality.

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