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South Centre Comments on Tax Certainty Framework for Issues Related to Amount A

I. Background

The South Centre is the intergovernmental organization of developing countries that helps developing countries to combine their efforts and expertise to promote their common interests in the international arena. The South Centre has 54 Member States coming from the three developing country regions of Africa, Asia, and Latin America and the Caribbean. It was established by an Intergovernmental Agreement which came into force on 31 July 1995. Its headquarters are in Geneva, Switzerland.

The South Centre in 2016 launched the South Centre Tax Initiative (SCTI). This is the organisation's flagship program for promoting South-South cooperation among developing countries in international tax matters.

The South Centre offers its comments to the OECD Inclusive Framework's Task Force on Digital Economy (TFDE) on the Tax Certainty Framework for Issues Related to Amount A.

II. Overview

The scope of the new dispute resolution mechanism is extremely concerning, as potentially any action of a country relating to transfer pricing or profit attribution to permanent establishment can be called an "issue relating to Amount A" and taken away from domestic purview. In practical terms, if an MNE dislikes what a country does to make it pay due taxes, it can classify the dispute as an "issue relating to Amount A" and take it to this highly complex international mechanism where it is more likely to win. A likely unintended effect could be to facilitate "forum shopping" as MNEs may opt for the forum most convenient to pursue their interests.

The mechanism also extends to countries which do not have a tax treaty, and would thus force all countries which join Pillar One to begin using the MAP mechanism. If the dispute cannot be resolved within two years as per MAP, the international dispute resolution process would be triggered, taking away their sovereignty on this critical aspect.

The mechanism additionally seems to be aimed at making OECD standards universal and bypass the tax treaty negotiation process. Specifically, it seeks to universalise the so-called "Authorised OECD Approach" towards Functions Assets and Risks (FAR) based profit attribution and the OECD approach towards defining permanent

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establishments and how profits are attributed to them. It must be mentioned that these standards that allocate taxing rights reflect the interests and views of the developed countries.[1]

III. Specific Comments

i. Article [X] Mutual Agreement Procedure

This should be seen as an extension of the Mutual Agreement Procedure (MAP) process itself. It should not attempt to tinker with the structures codified under existing MAP processes or add new requirements. Hence, the relevant Articles should be kept to the bare minimum and focus on the process of the new mechanism only. The starting point for the new dispute resolution mechanism should be the MAP article in the bilateral tax treaty.

a. MNE able to file MAP Request before Either Jurisdiction

Article [X] (1) says members of a Covered Group can file a MAP request before either Contracting State, referencing Article 25 of the OECD Model. This is something many countries, especially developing countries, have expressed concern with, as the same provision also exist in the OECD Base Erosion and Profit Shifting (BEPS) Multilateral Instrument (MLI). Many developing countries have chosen not to apply this provision and have expressed reservations.

The larger ramifications are that if the MNE goes to the developing country and wants to begin MAP and is refused, it can go to its residence jurisdiction and trigger the MAP process. This will then begin the two year countdown after which countries will be forced to enter the international dispute resolution process where they will lose their tax sovereignty.

Recommendation: The wording should be modified to be consistent with Article 25 (1) of the UN Model Tax Convention where a party should only be able to file a MAP request in the State where it is a resident.

[1] Interaction of Transfer Pricing & Profit Attribution: Conceptual and Policy Issues for Developing Countries (South Centre Tax Cooperation Policy Brief 3, August 2018) By Dr. Vinay Kumar Singh. Available from https://www.southcentre.int/tax-cooperation-policy-brief-3-august-2018/

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b. MNE able to file MAP Requests for Hypothetical Events that have not Occurred

The new mechanism will apply to cases where the member of the Covered Group considers that taxation not in accordance with the Convention "has resulted" from the actions of one or both Contracting States. Thus, the taxation must have actually taken place to justify the initiation of the MAP request.

However, Article [X] (1) retains the exact language of Article 25 of the OECD Model Tax Convention which allows a MAP request to be initiated on the basis of hypothetical situations. It states: "*or will result for that member of a Covered Group in taxation connected with a Related Issue not in accordance with the provisions of that Existing Tax Agreement*".

It is unclear why when no action has taken place a dispute should arise. Thus, only if the taxation has actually taken place the MAP request should be entertained.

Recommendation: The phrase 'or will result' which is taken from Article 25 of the OECD Model Tax Convention should be deleted.

c. Overbroad definition of who can file a MAP request

Article [X] (1) allows a 'member of a Covered Group' to file a MAP request. This is simply too broad, as potentially any Group entity, whether affected or not, can file the request.

Recommendation: The text must be rephrased to only allow the affected member or segment to be able to access this feature.

d. Impact on Existing MAPs

It must be ensured that the new mechanism does not affect the existing MAP process; whether the case is eligible under MAP or not should also not be affected.

ii. Article 19 (Resolution of disputes with respect to Related Issues)

a. Scope

While delineating the scope, the most important consideration is that only unresolved issues actually related to Amount A should be covered under the scope of the dispute resolution panel. The present proposed definition of the related issue is too broad.

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The current wording seems to imply that any adjustments to an MNE group entity profit would automatically open up the avenue for the MNE to request the dispute resolution process. It is a widely acknowledged fact that there can be instances where the adjustment / addition is not related to Amount A. For example, if there is a group A which has three segments X, Y and Z and is in scope as its segment Y meets the scope and profitability threshold. In such a case a dispute related only to segment Y that impacts Amount A should be in scope of the proposed mechanism. This is also relevant to in-scope groups which have segments that are excluded from Amount A. This needs to be clarified as part of the definition of the scope.

There must be a materiality threshold of the quantum under dispute for applicability of the process to avoid wastage of resources since the proposed dispute resolution process will be a costly and resource intensive exercise. This approach will allow jurisdictions to rationally use valuable and often scarce administrative resources. Further, there would not be any challenge for the below threshold MAP cases since they will follow the existing MAP route which is already subjected to peer-review.

b. *Request for Dispute Resolution Panel (DRP)*

The ambit of this process would include transactions in jurisdictions between whom there exist no bilateral tax treaty. This cannot be allowed as there is no basis for a MAP case in such circumstances.

Recommendation 1: If the jurisdictions involved do not have a bilateral tax treaty, the MAP case should not be allowed.

Recommendation 2: At the time of making a request, the MNE should justify that the unresolved issues under consideration in MAP is related to Amount A.

c. *Appointment of dispute resolution panel members*

The panel would adjudicate disputes between/among jurisdictions on taxation matters which is a sovereign right and therefore any disagreements arising on such matters should be examined and opined on by a panel that represents sovereign fiscal interests. Further, there should not be any concern with respect to bias as the panel has to choose from the alternative outcomes presented to it.

Recommendation: The dispute resolution panel must consist solely of government officials.

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d. Dispute Resolution Panel Process

There is no rationale for MNEs providing additional explanations as any previous stand of the MNE group would have been examined in detail by the Competent Authority as part of the deliberations under the MAP proceedings. Even its inclusion within the commentary may be misleading and create false hopes for the MNE.

Recommendation: The MNE must not be allowed to provide further documentation justifying its stand in the DRP.

e. Precedence

The framework proposes to roll forward the decisions of DRP. Just as there is no codification of MAP resolutions holding any precedential value, any DRP decision should also be imparted the same status.

Recommendation: It must be clearly mentioned that DRP decisions do not have precedential value.

f. Costs of dispute resolution panel proceedings

Any DRP process should be conducted with the aim of being cost effective. The current listed ICSID schedule, which proposed as the default rule raises the cost of each DRP proceeding significantly.

Recommendation 1: The cost of DRP process would be minimised if there are only government officials on the panel.

Recommendation 2: Other reference databases that may have more economical remunerations may be explored to keep the cost minimal.

g. Extension of Amount A related mechanisms to jurisdictions with no bilateral tax treaty

The extension of the DRP process to jurisdictions which do not have a bilateral tax treaty is a matter of great concern. Any MAP process is based on the distribution of taxing rights between countries as per the treaty. In the absence of the treaty, there is lack of clarity on the basic of definition of a Permanent Establishment (PE), business income allocation and other issues. There is no commonly accepted version of Article 5 (PE) and Article 7 (Business Profits). These Articles vary from treaty to treaty and

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even the UN model and OECD model adopt different approaches. A single approach to these Articles will destabilise the existing tax treaty network which will not be in the interest of the developing countries.
Recommendation: The DRP process should not be extended to jurisdictions which do not have a bilateral tax treaty.

iii. Need to Move Away from MAP Proceedings Being Confidential

It is recognised that current conventional wisdom is that all MAP proceedings should be treated as confidential in every respect; even their existence is usually considered confidential to the parties concerned.

However, in virtually all MAP-related situations, the worldwide tax administration process would be significantly improved and more useful to all tax administrations and taxpayer groups, if proper disclosure of proceedings, and particularly the rationales for the decisions of the dispute resolution panels, is made. This would help to ensure more consistent decisions on similar issues, and create greater predictability and certainty, thus reducing the number of disputes. This is abundantly true for publicly available court decisions (where of course there is often legal precedential value), and would be the same for MAP proceedings (even without legal precedential value, which is confirmed in paragraph 28(j)).

Paragraph 28(g) reads in part:

> The dispute resolution panel shall select as its decision one of the proposed resolutions for the case submitted by the Competent Authorities with respect to each Related Issue and any threshold questions, *and shall not include a rationale or any other explanation of the decision*. … [Emphasis added.]

Recommendation: The MAP decisions under this mechanism should be made public. Sensitive taxpayer information can be redacted. This will greatly benefit developing countries who will be able to establish a learning curve and reduce the asymmetry in experience with the developed countries. This will give them a higher chance of prevailing in such disputes when appropriate.

iv. Capacity Building Efforts

This new and complex mechanism will be brought in for the first time. Constant capacity-building efforts especially for low-capacity jurisdictions are required. The South Centre is ready to support its Member States in this regard.

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