



Off the MAP: Dispute Resolution In the BEPS 2.0 Blueprints

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<p>Mark R. Martin is a principal and Thomas D. Bettge is a manager in the economic valuation services group of KPMG LLP's Washington National Tax practice.</p> <p>In this article, Martin and Bettge examine the dispute prevention and resolution mechanisms discussed in the OECD's pillar 1 blueprint for taxing the digital economy.</p>	

Despite some bumps, it appears likely that the OECD's work on the tax challenges of the digital economy — commonly referred to as BEPS 2.0 — may lead to a substantial overhaul of the international tax system, which may also require changing the system for resolving cross-border tax controversies. On October 12, 2020, the OECD released blueprints for pillars 1 and 2 for discussion at the October meeting of the inclusive framework on base erosion and profit shifting. While some key technical and political questions remain, and while the blueprints' contents remain open to negotiation, the pillar 1 blueprint's take on dispute prevention and resolution creates new horizons in tax controversy.

This article summarizes the dispute prevention and resolution mechanisms discussed in the pillar 1 blueprint, then offers reflections.

I. Introduction

The BEPS 2.0 work, meant to find consensus among the more than 130 members of the inclusive framework, involves two pillars. Pillar 1 addresses the allocation of taxing rights and income to market jurisdictions, and pillar 2 involves the implementation of a minimum tax framework known as the global anti-base-erosion (GLOBE) proposal. In early 2020 the inclusive framework expressed continued support for the pillar 2 work and endorsed the unified approach for pillar 1 recommended by the OECD secretariat. While Treasury Secretary Steven Mnuchin indicated in a June 2020 letter that the United States wanted to pause discussions on pillar 1 amid the COVID-19 pandemic, technical work has continued on both pillars, and the G-20 — including the United States — has reaffirmed its commitment to arriving at a consensus solution, with the time frame for doing so now extended to mid-2021.

Pillar 1 consists of two components: amount A, which would allocate a portion of deemed residual profits to a market jurisdiction using fractional apportionment; and amount B, which intends to standardize compensation for some routine marketing and distribution functions. Amount A is expressly recognized as a departure from the arm's-length standard, which forms the bedrock of the international transfer pricing system, while amount B is meant to operate consistently with the standard. The ill-defined amount C from earlier stages of the process has been replaced by a commitment to increased tax certainty.

Pillar 1 is intended as a substitute for unilateral measures to tax digital businesses, which have been introduced or proposed by several countries, including Canada, France, India, Italy, and the United Kingdom. The potential proliferation of those kinds of measures

has made achieving multilateral consensus on principles and rules for the apportionment of taxing rights and profits crucial: Widespread unilateral action threatens to compound uncertainty, particularly as countries look to address revenue shortfalls arising from the COVID-19 pandemic.

Without multilateral consensus, tax disputes would likely increase in both number and urgency as countries and taxpayers grapple with whether digital services taxes are covered by bilateral tax treaties. Ultimately, taxpayers might be left without an effective way to eliminate double tax. Yet the potential harm from unilateral measures is broader than just double taxation. Unilateral action on digital taxation could also affect trade and tariff policy, as in the case of U.S. threats to impose tariffs on French goods in response to France's DST.

At the same time, a solution at the OECD level — although clearly preferable to the alternative — would create its own strains on dispute resolution. Because the systems interact with each other and with existing tax rules, both pillars would amplify the complexity of issues potentially implicated by any given dispute. Similarly, because pillar 1 contemplates a reallocation of profits among more than two countries, and because pillar 2 — depending on the details of its architecture — might also have multilateral ramifications, some disputes might involve unprecedented numbers of jurisdictions.

II. Disputes and Amount A

Because of the potentially large number of jurisdictions that may be eligible to receive amount A and because multiple entities might bear the amount A liability, a multinational enterprise could be embroiled in nexus and profit allocation disputes in many countries, likely facing inconsistent application of rules. That would make it impractical, and more likely impossible, to avoid multiple layers of taxation on the same income with no effective means to resolve disputes. As a result, pillar 1 moves beyond the use of mutual agreement procedures under tax treaties to resolve controversies, proposing novel and complex rules for preventing and resolving disputes.

An amount A system with different documentation and filing requirements in potentially more than 100 countries would be overly burdensome to MNEs. To eliminate that burden, an amount A coordinating entity (AACE) in a multinational group would file a single self-assessment return and documentation package on behalf of the entire group with its lead tax administration (LTA) by an agreed filing deadline.

In most cases, the LTA will be in the jurisdiction where the MNE's ultimate parent entity is tax resident. However, if the tax administration in the jurisdiction of an MNE's ultimate parent is unable to act as LTA (for instance, because the jurisdiction has not adopted amount A rules), or if other tax administrations are more suitable, an approach will be developed to identify a surrogate LTA for the multinational group.

The LTA will review the self-assessment return and documentation package for obvious errors and may request clarification or additional information from the AACE. Within 15 months after the end of the relevant fiscal year (as is the case for country-by-country reports) or some other agreed-on time frame, the LTA will exchange the self-assessment return and documentation package with all affected tax administrations (ATAs), which are in jurisdictions where the MNE has a constituent entity, as well as in jurisdictions where it has market revenues that meet the applicable threshold (or did so in the previous year).¹ The ATAs and LTA are then free to independently audit the amount A self-assessment and make adjustments, although the pillar 1 blueprint notes that they may coordinate through a review panel process. If a panel is formed, the MNE could be given an opportunity to participate.

A. No Request for Certainty

If the MNE does not file a request for certainty, some or all ATAs will likely want to audit the amount A self-assessment and documentation package. The LTA and ATAs may form a review

¹To allow for the contemplated exchange of materials, tax conventions and information exchange agreements will need to be modified and supplemented.

panel to coordinate their evaluation of the MNE's amount A position. If a panel is formed, it would accept or recommend modifications to the group's position on amount A, and its decision would be communicated to the multinational group, which may want to follow the proposal. If the administrations are unable to reach agreement, a determination panel could be formed, although it is anticipated that tax administrations will ordinarily not want to do so.

The pillar 1 blueprint notes that a mandatory binding dispute distinct from the early certainty dispute prevention mechanism described below will also be developed, but it does not provide any detail on how that mechanism will operate.

B. Request for Certainty

An important and innovative feature of pillar 1 is a voluntary procedure in which all aspects of amount A will be determined before tax adjustments are proposed by inclusive framework members. That would include the delineation of business lines and segments, the application of revenue-sourcing rules, the size of amount A, the attribution of profit to market jurisdictions, and the identification of relieving jurisdictions, which are required to eliminate double taxation by forgoing taxation of income subject to allocation under amount A. Importantly, under the pillar 1 blueprint, access to the certainty procedure cannot be declined unless the LTA is aware that a group's financial statements or other information relied on in calculating amount A are likely to change or be restated in a way that will affect amount A. In that case, a request for certainty may be declined, but the LTA can agree that a request can be submitted once the final position is known.

An AACE must submit a request for early certainty to the LTA by an agreed deadline, which the blueprint contemplates will be within six months of the end of the relevant fiscal year. The LTA will notify the ATAs within one month from the date it receives the request. As a result of the notification, no ATAs should commence any audit activity or issue assessments for topics specific to amount A for the relevant tax year pending the outcome of the certainty procedure.

1. Is a review panel needed?

When a multinational group makes a request for certainty, the LTA may conduct an initial review of the group's self-assessment return and conclude that a review by panel is not required. It may also recommend changes to the self-assessment return, which, if made by the MNE, will allow it to conclude that a panel is not required. In that case, the LTA will communicate its decision to the ATAs, generally when it exchanges the MNE's self-assessment return and documentation package. The determination must be accompanied by a summary of the review and an explanation for the decision.

If the LTA decides that no review by panel is needed, the ATAs have three months to submit comments, including requesting a panel review of specific perceived issues or expressing a preference for a panel review. A panel review request should be accompanied by a description of the ATA's specific concerns, which the LTA will discuss with the AACE to see if they can be addressed without harming the position of any other affected jurisdiction. If adequately addressed, the objecting ATA's request for a panel should be withdrawn.

If an affected jurisdiction's concerns cannot be resolved, or if an undetermined number of affected jurisdictions express a preference for review, a review panel could be formed. A panel could also be formed if the LTA does not conduct an initial review of the self-assessment return or determines a panel review is needed.² If none of the conditions is met and a review panel is not to be established, the LTA will inform the multinational group that the position set out in its self-assessment (reflecting any agreed changes) is accepted. That position is then binding on the group's constituent entities and on tax administrations in all inclusive framework member jurisdictions.

The optional review by the LTA could ultimately be one of the most significant elements of the early certainty procedure and could eliminate the time-consuming and administratively burdensome process of

² Further work will be conducted to determine the conditions under which a review panel should be constituted.

conducting a review panel (and potentially a determination panel). That could be particularly important during the early years of implementing amount A because requests for review panels could exceed the capacity of administrations to perform those reviews. The optional LTA review provides a mechanism to screen low-risk taxpayers out of the early certainty process, which would benefit taxpayers and tax administrations. If LTAs develop a reputation for thoroughly reviewing self-assessment returns and making reliable determinations that those returns should be accepted, the number of review and determination panels could be substantially reduced, which would enhance the likelihood that the amount A certainty process could remain effective long-term.

a. Review panel composition.

If a review panel is established, participating tax administrations will be drawn from the list of ATAs based on criteria to be established. However, it is contemplated that the review panel will include six to eight tax administrations, including the LTA, two to three relieving jurisdictions, and three to four amount A recipient — that is, market — jurisdictions. If applicable, the recipient jurisdiction members should include representatives from small and developing economies. Also, if the MNE has different business lines, the panel should ideally include jurisdictions affected by each allocation. The MNE would have no role in establishing the panel, which could be set up by the LTA or a secretariat, which the pillar 1 blueprint says could be established to assist with that process.

b. Review panel process.

The review panel will review an MNE's self-assessment, including all elements of the determination and allocation of amount A and the identification of relieving jurisdictions.

The LTA will interact with the MNE regarding any panel requests for information. The MNE may be asked to participate in telephone conferences or meetings with the review panel as a whole, although face-to-face meetings should generally be the exception. The MNE may be asked to set up a secure virtual data room where information can be made available to tax administrations.

Although the timeline for the panel review is unclear, it appears it should take between three and 12 months, with the average case taking approximately nine months. The lack of a mandatory end date for the review panel process promotes flexibility but could lead to unnecessary delay or abuse.

There are generally three potential outcomes from the panel review process: the panel does not agree with the multinational's self-assessment, which the MNE will not revise to conform to the panel's view; the panel fails to reach agreement; or the panel agrees with the MNE's self-assessment (including any changes requested by the panel and agreed to by the MNE).

If the review panel agrees with the multinational group's self-assessment, the LTA sends the recommendation that the self-assessment be accepted to all ATAs not on the panel. If no ATA objects to the review panel's recommendations within three months, acceptance is assumed and the LTA informs the MNE of that. The agreed and approved assessment is binding on the MNE's constituent entities and on tax administrations in all inclusive framework member jurisdictions.

If any ATA objects to the review panel's recommendation and that objection cannot be resolved, the LTA will inform the multinational group and all ATAs that relevant questions will be referred to a determination panel for a conclusive outcome. Significantly, even though 100 or more affected jurisdictions might agree with the panel recommendation, a single ATA can cause the review panel process to fail, even if the objection is unprincipled. It is hoped that will be rare and that ATAs will generally follow the review panel determination.

If the multinational group will not revise its self-assessment to conform to the panel's view, or if the taxpayer withdraws from the process, the early certainty process is complete, and the MNE will need to rely on domestic remedies to resolve any amount A disputes. It remains to be determined whether the ATAs would be bound by the resolution the MNE rejected. If the review panel fails to reach an agreement, the case will move to a determination panel, which is required to reach an agreement on the MNE's amount A position.

2. Is a determination panel needed?

If the review panel is unable to reach agreement or accommodate objections by other ATAs, the case is submitted to a determination panel, which must reach a decision. That ensures that an MNE that enters the process will obtain certainty on its amount A position. It remains to be determined whether an MNE would be required to accept the determination panel's decision as a prerequisite to entering the determination panel process.

The composition of the determination panel is still to be determined, including whether it is staffed by serving or former government officials, independent experts, or both; whether LTA or ATA representatives will be included; and whether the panel should have a chair and how that chair would be chosen.

The review panel will develop specific questions for the determination panel, together with alternative responses that reflect the different views held by panel members and ATAs. Those questions will not reopen elements settled by the review panel and agreed to by all ATAs. The determination panel will choose from those alternatives to make a decision on a last-best-offer basis. The decision should be made in six months, and a short summary of the decision will be provided to the LTA and ATAs. The panel's final determination will be binding on all inclusive framework members.

C. Other Amount A Procedures

1. In-scope procedure.

Some multinational groups may also want certainty from tax administrations on whether they are in or outside the scope of amount A. However, unlike the certainty process (which could be an annual process for some groups), it is likely that a group would require certainty regarding whether it is in the scope of amount A only once, or periodically after any change to its business structure or profitability. Thus, the pillar 1 blueprint contemplates that an in-scope certainty procedure might be developed.

While the procedure described above should address scope questions, the in-scope procedure provides an abbreviated means of resolving scope determinations without requiring consideration

of issues that may prove irrelevant if the MNE is found to fall outside the scope.

The process would begin with a request for in-scope certainty with the LTA no later than six months before the filing deadline for the self-assessment return. The MNE would file a specific self-assessment return and documentation package laying out its position for the scope issue. The LTA should review that position and discuss it with the MNE. If the LTA agrees with the position, it should send the materials to all inclusive framework members, including a recommendation that the position be accepted. If the LTA and MNE cannot reach agreement on the in-scope determination, the materials would be sent to the inclusive framework members with an explanation from the LTA why it disagrees with the MNE.

Inclusive framework tax administrations are given six weeks to respond to the LTA explaining their positions. If no objections are received, the position is approved. Any continuing disputes that cannot be resolved by the LTA and the other tax administrations will be submitted to a determination panel for a final determination.

2. Market jurisdiction determination panel.

MNEs must provide the LTA a list of market jurisdictions, defined as jurisdictions with pro rata in-scope revenue exceeding the market jurisdiction threshold in either of the most recent two years; and, if applicable, jurisdictions that had any plus-factor described in chapter 3 (nexus) of the pillar 1 blueprint. Further work will be conducted to ensure that all market jurisdictions are identified. If a jurisdiction is not included, it will not receive the self-assessment and documentation materials, and thus will not be able to effectively enforce amount A or participate in the early certainty process.

To address that concern, the pillar 1 blueprint contemplates that the LTA will provide the list of market jurisdictions to all members of the inclusive framework; that way, a jurisdiction can see if it is on the list. If not, it can contact the LTA with evidence that it should be added.

If the MNE agrees to put the jurisdiction on the list, that will address the administration's concerns. If it does not, a market jurisdiction determination panel may be formed to resolve the issue. That panel may include representatives

from the LTA and the tax authority asserting that it should be included on the list, as well as a chair. If the panel determines by majority vote that the tax authority should be on the list, that authority will be included as a market jurisdiction for exchanging the multinational group's amount A self-assessment return and documentation package, as well as for any amount A early certainty process for the relevant tax year. However, being included on the list does not ensure entitlement to an amount A allocation.

3. Late request for certainty.

When a multinational group does not make a request for tax certainty and subsequently is subject to tax adjustments for its self-assessment of amount A in at least one jurisdiction, it is unclear whether the group could file a late request for certainty, which could benefit both the MNE and other jurisdictions by streamlining the dispute process. Because the MNE did not request early certainty, it would not be guaranteed access to the process, although it is envisioned that in most cases a late request would be accepted. Work is also being conducted on a mandatory binding dispute resolution mechanism when adjustments are made.

III. Beyond Amount A

There is risk that an unrelated transfer pricing adjustment may be made after an early certainty ruling for amount A that could affect the prior amount A determination. For example, the adjustment could affect the entities identified as relieving jurisdictions or the amounts allocated to market jurisdictions. The pillar 1 blueprint acknowledges that issue but does not propose a solution.

More broadly, the pillar 1 blueprint recognizes that enhanced dispute prevention and resolution mechanisms may be needed beyond amount A. It focuses on enhancements to existing dispute resolution tools, including the increased use of the international compliance assurance program and joint audits, as well as improved processes for advance pricing agreements (bilateral or multilateral). The blueprint also includes recommendations to strengthen MAP infrastructure and processes, including limiting procedural barriers to MAPs.

Disputes regarding the application of amount B (for example, whether activities are within the scope of baseline marketing and distribution activities) would also be subject to mandatory binding dispute resolution as a last resort, but the blueprint provides no details on that process.

The pillar 1 blueprint provides that binding arbitration will be available for all disputes regarding transfer pricing and permanent establishment issues for multinational groups that are within the scope of amount A, which would be a procedure of last resort after all other dispute resolution tools are exhausted. Thus, the procedure would not apply if disputes are covered by existing mandatory and binding dispute resolution mechanisms, which would continue to apply. However, the suggested mandatory procedure would not apply to some developing economies (estimated to be more than 50 jurisdictions), because they do not have material MAP experience or the infrastructure to handle mandatory binding dispute resolution. Even so, those jurisdictions would commit to an elective binding mechanism that would be triggered when their competent authorities were unable to resolve a MAP case in an agreed period.

For groups outside the scope of amount A, the pillar 1 blueprint indicates that consideration will be given to the respective benefits of mandatory binding and nonbinding dispute resolution processes. On the whole, the blueprint includes little detail on dispute resolution procedures for issues not related to amount A.

As described, the rationale for providing the new right to mandatory binding dispute resolution for MNEs in scope of amount A is tied to the reality that a transfer pricing or PE dispute arising after the amount A certainty procedure could undermine the entire process because the underlying assumptions relied on might change. The pillar 1 blueprint acknowledges that access to binding dispute resolution may also be viewed as quid pro quo for the increased burden associated with the new taxing rights and allocation rules of amount A.

IV. Reflections

A. The Amount A Certainty Process

While the two-tier panel process may be more eye-catching, the LTA's optional initial review of the self-assessment will likely be key to the success or failure of the amount A certainty process. The blueprint notes that pillar 1 may be phased in, beginning with the largest taxpayers and expanding to the full set of in-scope taxpayers above the global revenue threshold. Using an illustrative (but not yet agreed) €750 million threshold, the OECD estimates that about 2,300 MNEs would be in scope, while only around 350 would be in scope in the first year if the threshold were phased in beginning at €10 billion.

The blueprint also acknowledges that many in-scope MNEs would likely use the early certainty process in the initial years of the amount A rollout. Even with a phase-in, processing early certainty requests for those taxpayers would likely result in significant burdens for tax administrations. While the panel system provides an invaluable backdrop, pursuing every case through negotiation among the ATAs followed by two separate panels will not be feasible: If the system succeeds, it will likely be because initial reviews can efficiently dispose of low-risk cases in less than a year of the filing of the MNE's self-assessment.

On the other hand, hazy timing for some parts of the process and the lack of specified drop-dead dates for the review and determination panel create room for delay and abuse. Similar flexibility in some treaty relationships has allowed some countries to avoid sending cases to mandatory arbitration proceedings by simply extending time frames. Clarification on timing and mechanisms to ensure that cases progress would help guard against that danger.

Perhaps the greatest lacuna is the lack of clarity on how amount A would be affected by transfer pricing adjustments. The pillar 1 blueprint acknowledges that some jurisdictions believe the mandatory binding dispute resolution process for transfer pricing and PE issues faced by amount A taxpayers should be separate from, rather than integrated with, the amount A process. Coordinating two separate systems could prove complex, and clear rules are needed here.

Last, it is important to reflect on the potentially enormous scope of amount A disputes, which could cover information technology audits regarding the application of sourcing rules, segmentation challenges, and determinations of whether noneligible generally accepted accounting principles are materially distortive. Those are areas outside the normal competence of taxing authorities and are better suited to independent auditors and financial regulators. Whether the process can adequately address those concerns remains to be seen.

B. What Happened to Arbitration?

Early debate over the function of dispute resolution for pillar 1 centered on mandatory binding arbitration. While many jurisdictions favored arbitration, several developing countries, as well as nongovernmental organizations that advocate for the interests of developing countries, took issue with the use of mandatory arbitration. Broadly, there seem to have been two primary concerns: that mandatory arbitration would infringe on countries' sovereignty (and possibly impinge on their constitutions); and that developing countries would be unable to approach arbitration with the same resources and sophistication as their wealthier counterparts and thus experience worse results.

Those concerns are serious, and it appears the OECD has taken them seriously, including by floating the possibility of an independent secretariat to assist with the administration of the amount A process. Importantly, what the pillar 1 blueprint proposes is not arbitration, but a multitiered system that seeks to build consensus among affected countries while retaining an independent, quasi-arbitral determination panel as a backstop to ensure disputes are resolved. Although the composition of the panel remains to be determined, the suggestion that current or former tax officials be included may assuage concerns that a panel of independent experts might favor developed nations.

It is interesting, however, that the blueprint contemplates that the determination panel would prepare a summary of the reasoning for its conclusions. Many countries conduct last-best-offer arbitration, also known as baseball-style arbitration, in which the arbitrator selects one of

several proposed resolutions and does not offer a statement of its reasoning. Others apply reasoned decision arbitration, in which the arbitrator comes to its own conclusion and describes its reasoning. In general, the approach adopted for the amount A determination panel more closely resembles baseball-style arbitration, but the fact that the panel will provide ATAs a summary of its rationale is more akin to reasoned decision arbitration. Although that statement of reasoning should not have any precedential value, it may raise concerns among developing countries that those summaries could become quasi-precedential and thus impinge on their sovereignty.

The blueprint's approach appears to have been inspired in part by developments under the EU arbitration convention. Although that convention provides for mandatory arbitration, the EU has noted serious shortcomings in both access and effectiveness and issued Directive 2017/1852, effective as of July 1, 2019, to address them. The directive provides for the constitution of an advisory commission at the taxpayer's option after two years have elapsed in MAP. The commission, which will include the two competent authorities and three independent members, is to deliver within six months an opinion that will be binding unless the competent authorities agree to another solution within six months after issuance of the opinion. Like the amount A review panel process, the modified EU dispute resolution procedures give the jurisdictions concerned the opportunity to participate directly in the quasi-arbitral advisory commission process and ensure that the jurisdictions, if dissatisfied with the commission's proposed resolution, have the chance to agree on an alternative.

However, the amount A certainty process goes beyond the EU's approach by imposing a second panel with decision-making power. It remains to be seen whether the process will be palatable to developing countries.

C. What About Pillar 2?

The pillar 2 GLOBE proposal consists of an income inclusion rule (IIR) and an undertaxed payments rule (UTPR), which operate together to tax MNEs at a to-be-agreed minimum rate. The

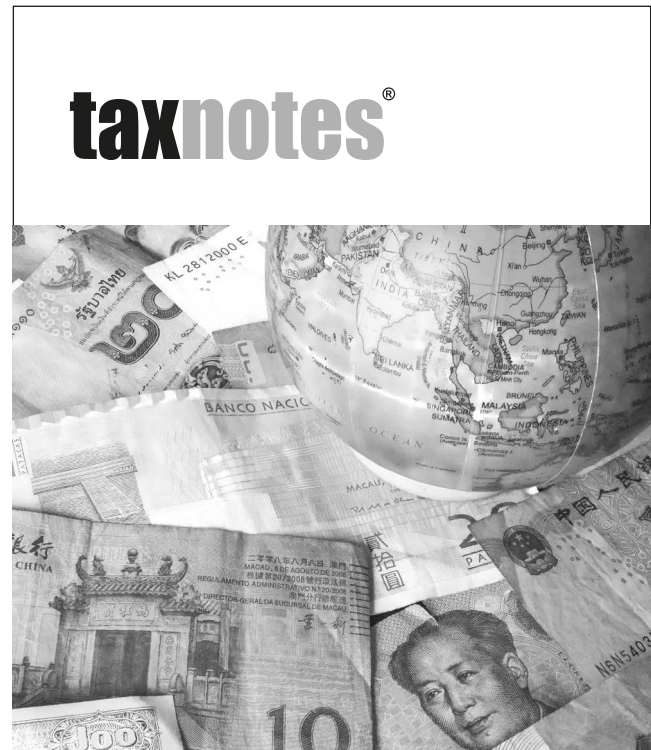
IIR would require an MNE's ultimate parent entity (or, in some cases, other entities) to pay the GLOBE top-up tax necessary to reach the minimum rate, with the UTPR — which targets deductible payments to low-tax related parties — serving as a backstop. Those rules are complemented by an independent treaty-based subject-to-tax rule, which would tax outbound payments to affiliates in low-tax jurisdictions and could be applied through withholding. Unlike the subject-to-tax rule, which operates in the context of existing tax treaties, the IIR and UTPR are a new system. Despite detailed coordination rules in the pillar 2 blueprint, countries might apply the IIR or UTPR inconsistently, creating risks of double tax. The blueprint indicates the U.S. global intangible low-taxed income regime should be grandfathered as an IIR-equivalent regime but has yet to fully address the coordination between GILTI and GLOBE, which likewise could lead to double tax.

As described above, the pillar 1 blueprint lays out an intricate (although incomplete) plan for dispute resolution. Yet scant consideration has been paid to pillar 2 controversies: The pillar 2 blueprint recognizes that multilateral controversies may arise but is largely content with the idea that the existing dispute resolution framework based on treaty MAP provisions — which encourage, but do not require, resolution — will adequately address the problems. That seems overly sanguine. The near-total absence of dispute prevention and resolution in the pillar 2 blueprint may stem from a comparative lack of political focus: While mandatory binding dispute resolution has long been regarded by some stakeholders as an integral component of a pillar 1 solution, the same attention has not been paid to pillar 2 disputes.

V. Conclusion

The pillar 1 blueprint's approach to dispute resolution may be daunting, and there are certainly key issues that remain to be addressed — in addition to the overarching political questions. Yet regardless of the success of the pillar 1 project, the work done should prove valuable as a blueprint for future work on both multilateral and bilateral dispute resolution.

It is critical that any BEPS 2.0 solution include dispute prevention and resolution mechanisms that are mandatory, efficient, and promote quality outcomes. The amount A procedure is highly innovative but is not yet fully coordinated with transfer pricing and PE disputes — to say nothing of pillar 2 and other international tax concerns. While separately addressing those areas may be expedient as a political matter, care must be given to ensure effective and appropriate coordination.³ ■



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