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MAPping unchartered territory

The recent FTT decision granting two Glencore entities a stay of their diverted profits tax and corporation tax appeal proceedings offers important insights into the interaction between domestic appeals and the mutual agreement procedures provided for in double tax treaties. HMRC sought to resist the taxpayers' stay application on the basis that the domestic appeals should come first. That is striking, particularly in light of the focus on making MAPs more effective dispute resolution mechanisms as part of the BEPS project. The decision also indicates that DPT and other UK domestic anti-avoidance rules may not be immune from challenge under double tax treaties.

In *Glencore Energy Ltd and another v HMRC* [2019] UKFTT 438 TC, the First-tier Tribunal (***FTT***) has granted a stay application requested by two Glencore entities (one UK resident and one Swiss resident) which are appealing various corporation tax and diverted profits tax (***DPT***) assessments. That may not sound particularly newsworthy, but the decision offers some important insights into the interaction between domestic appeals and mutual agreement procedures (***MAPs***) which are provided for in double tax treaties.

Background to the appeals

Some may recall that the arrangements between these two companies formed part of the background to an unsuccessful judicial review application in 2017 in respect of a DPT charge levied by HMRC *(R (on the application of Glencore Energy UK Ltd) v Revenue and Customs Commissioners* [2017] EWCA Civ 1716).

The stay application judgment explains that the dispute with HMRC relates to the attribution of profit from oil trading activity between the UK and Switzerland. The challenges raised range from transfer pricing, permanent establishment and DPT to the application of rules such as the derivative contracts unallowable purpose rule in section 690 Corporation Tax Act 2009 (***CTA 2009***) and the so-called profit transfer TAARs under sections 695A and 1305A CTA 2009.

The taxpayers have appealed the various charging and closure notices received to the FTT. Additionally, the taxpayers considered that since the challenges raised by HMRC all fundamentally relate to the attribution of profit between the UK and Swiss entities, that profit attribution issue is capable of being resolved by way of a MAP between the UK and Swiss competent authorities under the UK-Swiss double tax treaty. The taxpayers therefore made a MAP request which covered not only the permanent establishment and transfer pricing issues (which are expressly within the scope of the permanent establishment (Article 7) and transfer pricing (Article 9) provisions of the treaty), but also (notably) the DPT charge and the unallowable purpose and profit transfer TAARs in CTA 2009.

MAPs and BEPS Action 14

Treaty based MAPs can sometimes be a bit of a damp squib in circumstances where the taxpayer has no recourse if the competent authorities are unable to come to an agreement. One of the objectives coming out of the work on BEPS Action 14 was to make MAP more effective by encouraging countries to include mandatory binding arbitration in their tax treaties, via the MLI or otherwise. These arbitration provisions are designed to give MAPs more "teeth" because the taxpayer can force a resolution of the issues if the competent authorities are unable to reach agreement on the issues within a particular timeframe. This in turn should prevent discussions between competent authorities drifting.

One of the objectives coming out of the work on BEPS Action 14 was to make MAP more effective by encouraging countries to include mandatory binding arbitration in their tax treaties.

The UK-Swiss treaty, however, already provides for mandatory binding arbitration. If the competent authorities have not come to an agreement within three years of the presentation of the taxpayer's case then the taxpayer can request that the outstanding issues are referred for binding arbitration, unless a decision on the issues has already been rendered by a national court.

Is it possible for a DPT charge to be resolved through MAP?

At the time when DPT was enacted, HMRC made it clear that it considered DPT to be "treaty-proof" on the basis that it did not consider it to be a tax substantially similar to corporation tax and that it should be considered as an anti-abuse measure which is not afforded treaty protection.

Many would disagree, however, and the taxpayers have sought to put this to the test by including the DPT charges within the scope of their MAP requests. The taxpayers' arguments as to why they consider DPT to be substantially similar to corporation tax (and therefore within Article 2 of the treaty) are set out at paragraph 11 of the judgment. Though the taxpayers' arguments on this point were not subject to judicial comment, paragraph 24 of the judgment does highlight that HMRC "*accepted that the issue of whether it is appropriate for DPT to be considered in the MAP was a matter that could be discussed within that procedure.*" That acceptance reflected HMRC's position at the hearing of the stay application, and in effect HMRC conceded that whether or not DPT is "treaty-proof" is a question appropriate for discussion between competent authorities under double tax treaties.

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The arguments put forward by the taxpayers focus on the various overlaps between the transfer pricing rules in Part 4 TIOPA 2010 and the DPT regime:

- HMRC's stated aim is to use DPT to incentivise taxpayers into settling their transfer pricing under the corporation tax regime, and that is clear from features of the DPT regime such as the review period which gives taxpayers an opportunity to avoid a DPT charge by conceding their transfer pricing position;
- the transfer pricing rules and the DPT rules are applicable to the same sorts of arrangements, due to the similarity between the definitions of "actual provision" for the purposes of the transfer pricing rules and "material provision" for the purposes of the DPT rules;
- the charge to DPT is calculated in line with transfer pricing principles. Even if the transaction is recharacterised under the DPT rules by reference to a "relevant alternative provision" (***RAP***), the calculation of the DPT charge is still calculated on transfer pricing principles as applied to the RAP; and
- if taxpayers accept transfer pricing adjustments within the review period then this has a direct impact on the quantum of the DPT charge. As a result of section 100A Finance Act 2015 (which was introduced by Finance Act 2019), a taxpayer cannot be charged both to corporation tax and DPT on the same amount; DPT takes priority over the corporation tax charge.

Finally, any procedural differences between transfer pricing and DPT are not thought to disturb the conclusion that DPT is substantially similar to corporation tax, because they do not go to the substance of the tax.

It remains to be seen how this will unfold over the course of the MAP discussions, and it is possible that this issue could be subject to arbitration proceedings in due course.

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What about other anti-avoidance rules?

Can challenges such as the unallowable purpose rule or the profit transfer TAARs be dealt with under a MAP?

We think they can be. Our view is that the effect of the transfer pricing article in the treaty (Article 9(1) in this case) is to restrict a contracting state's ability to apply their domestic law so as to adjust the profit of a company below that which would be permissible under the arm's length principle. It should therefore be viewed as a limiting provision in that sense.

In other words, contracting states have abrogated the right to make adjustments to a taxpayer's profits if that would result in taxation on more than an arm's length return - since that could lead to double taxation on that amount in both contracting states. So, for example, the UK would be precluded by Article 9 from applying rules such as the profit transfer TAARs to disallow deductions to the extent that would result in a UK company being taxed on more than an arm's length return in a transaction it entered into with a Swiss group company.

That in turn would mean that an agreement between the UK and Swiss competent authorities of the correct arm's length price should be enough to dispose of all challenges

raised by HMRC (not just those expressly made under Part 4 TIOPA).

This will not always be possible, however. Article 9(1) is subject to the inherent anti-abuse rule which applies to all treaty provisions and prevents any taxpayer from invoking the protection of a treaty in order to derive unintended treaty benefits. However, paragraph 61 of the OECD Commentary on the Model Tax Convention on Income and Capital 2017 (**the *OECD Commentary***) on Article 1 suggests that this is a high bar. For the anti-abuse principle to apply, taxpayers must have a main purpose of securing a more favourable treatment which is contrary to the object and purpose of the treaty. That will be a question of fact in each case. However, the invoking of a domestic anti-avoidance measure by a contracting state would not be enough in itself for a taxpayer to lose treaty protection. It is quite possible that a taxpayer may fall foul of a domestic anti-avoidance measure and yet have a main purpose which is in line with the object and purpose of the treaty.

Stay application

The judgment explains that the Swiss competent authority has formally accepted the MAP requests and had an initial discussion with the UK competent authority. However, the taxpayers were told that the MAP would need to be put on hold whilst domestic remedies were being pursued in the UK courts. Nevertheless, both competent authorities confirmed they were willing to progress discussions once the domestic appeals had been stayed. Requiring the stay of domestic proceedings to progress a MAP (rather than an arbitration under a MAP) is not expressly required under the terms of the treaty but it is the approach advocated by paragraph 76 of the OECD Commentary on Article 25.

The taxpayers therefore applied to the FTT for a stay of their domestic appeals so that the MAP could be progressed and (strikingly, in our view) HMRC resisted that application – effectively denying the taxpayers the right to take steps to allow the MAP discussions to progress. Happily for the taxpayers, the FTT granted the stay application. If it had refused to do so then the MAP would have been put on indefinite hold and, once the FTT had in due course rendered a decision in the case, the taxpayers would have been deprived of their right to request mandatory binding arbitration of any issues determined by the FTT even if the MAP was reopened at a later stage.

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Taxpayers might hope that, in circumstances where the UK competent authority is prepared to progress MAP discussions subject to a stay of domestic proceedings being granted, HMRC would not resist that stay application. This is particularly so when viewed against the backdrop of BEPS Action 14 and the trend towards resolving disagreements through MAP-based arbitration where possible. However, it seems that taxpayers cannot necessarily assume that HMRC as a whole will take a consistent approach in this context.

Encouragingly, the FTT took account of the BEPS Action 14 report in coming to its decision on the stay application. For example, the fact that the UK and Switzerland do not currently have an agreed set of rules which would govern any arbitration under MAP was not thought to be relevant to the merits of the application given the focus in the report on "*developing solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP*".

The FTT also held that, in accordance with paragraph 44 of the OECD Commentary on Article 25, the choice of redress (as between a domestic appeal and MAP) should lie with the taxpayers in this case and not with HMRC. The complexity of the issues were viewed as factors that pointed in favour of, rather than against, a stay.

HMRC argued that the stay should be refused because the FTT had been seized of the appeals and that the appeals should therefore proceed towards a substantive hearing rather than be subject to an indefinite stay. The FTT rightly rejected that argument, which, if correct, could preclude taxpayers from accessing MAP altogether once they have submitted an appeal (even on a protective basis) to the FTT.

The FTT did not consider the stay to be an indefinite one, noting in particular the three year time limit in the treaty before the taxpayers could refer the matter to arbitration and the parties having the right to make applications for the stay to be lifted in the future in appropriate circumstances.

What next?

Overall, this decision (which has not been appealed by HMRC) should be encouraging for taxpayers looking to resolve their disputes via MAP in circumstances where they are required to stay their domestic appeals in order to do so. Further, the MAP itself raises some important questions as to the scope of taxpayers' rights under double tax treaties, including their application to DPT and anti-avoidance type challenges.

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