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Mutual Agreement Procedure in Ukraine

1. Introduction

In accordance with the global campaign to address base erosion and profit shifting (BEPS), Ukraine decided to join the Inclusive Framework on BEPS and to take the obligations under its minimum standards in November 2016. The minimum standards include an agreement to secure progress on dispute resolution, with the strong political commitment to the effective and timely resolution of tax treaty disputes through the MAP³. It should be added that the requirements to implement the minimum standards demand the compliance within the framework of peer review and monitoring procedure that will ensure a level playing field.

Following the international commitments, Verkhovna Rada of Ukraine adopted the Law of Ukraine No. 466-IX "On amendments to the Tax Code of Ukraine regarding improvement of tax administration, elimination of technical and logical inconsistencies in tax legislation" on its

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³ OECD (2017), *Background Brief: Inclusive Framework on BEPS, January 2017*. Paris, OECD. URL: <http://www.oecd.org/tax/beps/background-brief-inclusive-framework-for-beps-implementation.pdf> (Last accessed: 30.04.2021).

penary meeting dated 16 January 2020. Its main purpose was to implement the BEPS standards into the domestic legal order including the ones related to effective application of MAP.

Taking into consideration such steps, it seems well-grounded that the international commitments of Ukraine and the global process of improvement of MAP as a mechanism of tax treaty dispute resolution determine the necessity to assess the existing level of the legal regulation of MAP in Ukraine. The results of such analysis might help to better understand the possible ways and directions for further work on improvement of tax treaty policy in Ukraine as well as domestic regulation of tax treaty application.

The long history of the MAP has not been avoided by the attention of researchers because of the uniqueness of MAP as a mechanism for dispute resolution in case of different views on application and interpretation of treaty provisions between the involved jurisdictions that may result in taxation not in accordance with the conventional provisions. It has been in the center of research interest of Z.-D. Altman⁴, C. Dimitropoulou, S. Govind, L. Turcan⁵, S. Kim⁶, M. Lombardo⁷, P.-K. Sidhu⁸, to name a few. Nevertheless, the features of MAP in Ukraine have not been widely analyzed or discussed. Due to the limited practice of application of the potential of MAP, only a small number of researchers refer to the issue of the MAP regulation in Ukraine. Among them one could

⁴ Altman, Z.-D. (2005), *Dispute Resolution under Tax Treaties*. Amsterdam: IBFD, 492 p.

⁵ Dimitropoulou, C., Govind, S., Turcan, L. (2018), Applying Modern, Disruptive Technologies to Improve the Effectiveness of Tax Treaty Dispute Resolution: Part 1. *Intertax*, Vol. 46, Issue 11, pp. 856–872.

⁶ Kim, S. (2014), *Study on Arbitration as Institution of International Tax Dispute Resolution: Within the Ambit of MAP as Suggested by the OECD*. Seoul: Seoul National University School of Law, 383 p.

⁷ Lombardo, M. (2008), The Mutual Agreement Procedure (Art. 25 OECD MC) – A Tool to Overcome Interpretation problems? In: *Fundamental Issues and Practical Problems in Tax Treaty Interpretation*. Ed. by M. Schilcher & P. Weninger. Wien: LINDE, pp. 457–480.

⁸ Sidhu, P.-K. (2014), Is the Mutual Agreement Procedure Past Its “Best-Before Date” and Does the Future of Tax Dispute Resolution Lie in Mediation and Arbitration? *Bulletin for International Taxation*, Vol. 68, No. 11, pp. 590–605

refer to the publications of P. Selezen⁹, M. Karmalita, A. Kharchenko¹⁰, O. Minin, M. Minina¹¹. Their works are dedicated to the study of the role of MAP as an instrument of interaction between tax authorities and taxpayers in general or the normative limitations of MAP potential in tax dispute resolution but there is not much scholarship on the features of legal regulation of MAP in the context of the changes in the domestic legislation and the tax treaty network of Ukraine.

The purpose of this article is to study the features of legal regulation of MAP in Ukraine based on the provisions of double taxation treaties of Ukraine and the relevant provisions of domestic legal acts amended in 2020 as well as the recommendations of the OECD Model Tax Convention (OECD MTC).

The methods of research determine its methodological basis and include the general and special ones. Systematic approach belongs to the principal methods due to its recognition as the common one and give the opportunity to define the present issues of the application of MAP following the provisions of double taxation treaties and domestic legislation. The logical semantic method is used based on the need to clarify the terms and conditions of domestic legislation including the Tax Code of Ukraine. The proposals and conclusions are formulated based on the application of the formal method in the process of analysis the domestic legislation and judicial cases in Ukraine from the point of view of international treaties' implementation.

The structure of the article is determined by its purpose and consists of three main parts (1) MAP as a mechanism of dispute resolution in

⁹ Selezen, P. (2018), Vzaemouzgodjuvalna procedura u konteksti kampanii z protydii rozmyvannju bazy opodatkovannya ta peremischennya prybutkiv [Mutual agreement procedure in the context of the campaign on counteraction to base erosion and profit shifting]. *Pravo i suspilstvo*, Vol. 3, pp. 313–319.

¹⁰ Karmalita, M. & Kharchenko, A. (2018), Vzaemouzgodzhuvalna procedura jak pravovyi instrument vzaemodii platnikiv podatkov ta ta kontroljujuchih orgniv [Mutual agreement procedure as a legal instrument of interaction between taxpayers and controlling authorities]. *Pravo ta derzhavne upravlinnya*, No. 1, Vol. 1, pp. 118–122.

¹¹ Minin, O. & Minina, M. (2016), Mekhanizmy zastosuvannya i obmezhenist priorytetnosti okremykh norm podatkovogo zakonodavstva [Mechanisms of application and limits of hierarchy of some provisions of tax legislation]. *Juridichniy zhurnal*, № 1–2, pp. 104–106.

Ukraine; (2) MAP and double taxation treaties of Ukraine; (3) possible ways of the improvement of the MAP regulation in Ukraine.

Based on the research results, it is stated that the regulation of MAP in Ukraine might be improved due to the present gaps and issues having potential negative impact on the application of MAP as dispute resolution mechanism. The recent changes of domestic legislation related to MAP should be assessed positively because creates a solid basis for implementation of MAP into domestic legal order but it is not enough for effective functioning.

2. Map as a mechanism of dispute resolution in Ukraine

The essence of the MAP could be defined as a procedural mechanism in double taxation treaties that allows designated representatives of the competent authorities from the governments of the contracting states to interact with the intent to resolve international tax disputes in cases of double taxation (juridical and economic) or inconsistencies in the interpretation and/or application of treaty provisions¹². A similar approach to define MAP is shared by M. Lombardo: "The mutual agreement procedure is a special procedure outside domestic law aimed at resolving the dispute on an amicable basis, i.e. by the agreement between the competent authorities of the contracting states, in cases where tax has been charged, or is going to be charged, in disregard of the provisions of a tax treaty, with a view to securing the uniform application and interpretation of the tax convention in both countries"¹³. At the same time, A. Christians proposes to take into consideration the nature of the MAP as the mean of dispute resolution based on the provisions of double taxation treaties and points out at the diplomatic nature of MAP as a dispute resolution mechanism with long history of application¹⁴.

¹² OECD (2007), *Manual of Effective Mutual Agreement Procedures (MEMAP)*. February 2007 Version. Paris: Centre for Tax Policy and Administration, p. 8.

¹³ Lombardo, M. (2008), The Mutual Agreement Procedure (Art. 25 OECD MC) – A Tool to Overcome Interpretation problems? In: *Fundamental Issues and Practical Problems in Tax Treaty Interpretation*. Ed. by M. Schilcher & P. Weninger. Wien: LINDE., p. 459.

¹⁴ Christians, A. (2012), How Nations Share. *Indiana Law Journal*, Vol. 87, pp. 1433.

Based on the practice of MAP with the participation of the competent authorities of Ukraine, it seems that MAP has not been well-known and recognized as effective instrument for resolving issues between taxpayers and tax authorities until 2020. There is no doubt that the main determinant of this situation was the absence of domestic normative basis allowing the taxpayers to initiate the MAP. Nevertheless, the competent authorities of Ukraine have a limited practice of resolving interpretation and application issues via MAP in the process of implementation of double taxation treaties that is confirmed by few cases from administrative and court practice in Ukraine.

Based on the existing sources of public information, it might be possible to identify only two attempts of application of MAP in the process of tax dispute resolution:

1. In 2012, the taxpayer approached to the tax authorities of Ukraine with the intent to clarify the provisions of Art. 10(3)(a) of the double taxation treaty between Ukraine and the Netherlands¹⁵. This provision contains two key conditions for the application of zero rate of withholding tax in case of paying dividends from the territory of Ukraine:

- the recipient of dividends in the Netherlands holds directly at least 50 % of the capital of the Ukrainian company paying the dividends;
- the recipient of dividends in Netherlands should have made an investment of at least 300 000 USD or its equivalent in the national currency of the contracting state in the capital of the Ukrainian company paying the dividends.

The conventional norms do not include the definition of the term 'investments'. As a result, the competent authorities had to decide in the framework of MAP whether the term 'investments' might be applied to the situation in which the resident of the Netherlands buys another Dutch resident company that had previously made an investment in the capital of Ukrainian company paying the dividends. The competent authorities reached an agreement and explained that the situation of buying of the existing Dutch company that had made investments in the

¹⁵ *List Derjavnoi Podatkovoyi Administracii Ukrayiny* [Letter of State Tax Administration of Ukraine], No. 951/0/61-12/15-1415, 28 August 2012. URL: <http://law.dt-kt.com/lyst-derzhavnanyi-podatkovoyi-sluzhby-ukr-12/> (Last accessed: 30.04.2021).

capital of the Ukrainian company could not be equal to the situation in which the resident of the Netherlands makes similar investments directly. Consequently, the resident of the Netherlands could not have the right to apply the zero rate of withholding tax if the investments were not directly made in the capital of the Ukrainian company.

2. In 2012, the taxpayer tried to suspend the judicial proceedings in the Kyiv Administrative Court of Appeal that had been started based on the claim of the tax authorities (decision in case No. 2a-7088/12/2670, 4 October 2012). The demands of the taxpayer were determined by the statement that the non-resident was involved in the MAP initiated in the USA in accordance with Art. 26 of the double taxation treaty with the USA¹⁶.

In the opinion of the taxpayer, the essence and the nature of the double taxation treaty between Ukraine and the USA, as an international treaty, points out that the interpretation of competent authorities has a priority over the interpretation of any public authorities of contracting states separately. Obviously, this argument is implicitly rooted in the provisions of the Vienna Convention on the Law of Treaties.

The court admitted that it had the right to suspend the judicial proceedings until the established date if there were well-grounded reasons for such a step (Art. 156(4)(2) of the Code of Administrative Judicial Procedure of Ukraine). Nevertheless, the court refused to recognize the basis of the taxpayer's demands and based its decision by the absence of the proper evidence that the nonresident had initiated the MAP. There is no opportunity to assess the evidence of the taxpayer because the court decision does not contain any mentions of their forms or types. Nevertheless, it is worthwhile mentioning that the possibility of parallel dispute resolution procedures was neither allowed nor denied by the Ukrainian legislator in the case of simultaneous initiation of judicial proceedings and MAP at that time. Consequently, the court avoided any reference to this issue in its decision.

Besides the abovementioned attempts to apply the potential of MAP, one should look at the decision of the Odesa Administrative Court of

¹⁶ *Rishennya Kyivskogo Administratyvnogo Apelyacynogo Sudu* [Decision of the Kyiv Administrative Court of Appeal], case No. 2a-7088/12/2670, 4 October 2012. URL: <http://reyestr.court.gov.ua/Review/26335661> (Last accessed: 30.04.2021).

Appeal (decision in case No. 815/5010/17, 28 February 2018), in which the absence of will of competent authorities to reach an agreement on the basis of MAP could be represented as a reason for real losses in tax revenues¹⁷.

The position of the taxpayer was grounded by the reference to Art. 11(2) of the double taxation treaty with Cyprus. This provision states that the payment of interest to the resident of Cyprus by the Ukrainian resident may be taxed in Ukraine at a rate of two per cent of the gross amount if the beneficial owner of the interest is a resident of Cyprus. Nevertheless, the mode of application of this limitation must be agreed by mutual agreement of competent authorities. In the opinion of the taxpayer, the absence of mutual agreement between competent authorities does not allow the tax authorities to tax the payment of interest from the territory of Ukraine. Obviously, the tax authorities did not share the view of the taxpayer and insisted on the necessity of application of Art. 11(2) of the double taxation treaty with Cyprus.

The court agreed with the argumentation of the taxpayer and stated that Art. 11(2) of the double taxation treaty with Cyprus should be applied only under the condition of reaching the mutual agreement between the competent authorities of contracting states.

As it seems, the results of the judicial proceedings would have been the opposite if the competent authorities had concluded the mutual agreement on the basis of Art. 23 of the double taxation treaty with Cyprus. The absence of necessary will of competent authorities to conclude the mutual agreement costs loss in tax revenues that is multiplied by the number of Ukrainian taxpayers paying interests to the residents of Cyprus at the same time. It should be noted that Cyprus is the leader of investments in the form of liability instruments in Ukrainian companies as of October 2018. Consequently, this fact allows suggesting that the loss in tax revenues might be sufficient and underlines the necessity to accelerate the process of reaching the mutual agreement between the competent authorities on the basis of Art. 23 of the double taxation treaty with Cyprus.

¹⁷ *Rishennya Odeskogo Apelyaciynogo Administrativnogo Sudu* [Decision of the Odesa Administrative Court of Appeal], case No. 815/5010/17, 28 February 2018. URL: <http://reyestr.court.gov.ua/Review/72647386> (Last accessed: 30.04.2021).

As it seems, the changes implemented into the domestic tax legislation of Ukraine due to the abovementioned Law of Ukraine No. 466-IX dated 16 January 2020 will help to make MAP available to taxpayers because they receive the right to initiate it by submitting the application to the competent authorities of Ukraine. There is no wonder that the Ukrainian legislator referred to the standards of the OECD MTC and the minimum standards in accordance with Action 14 of the BEPS campaign. Nevertheless, there are features that might impact on the future practice of application of MAP either by competent authorities or by taxpayers.

3. MAP and double taxation treaties of Ukraine

Normative basis of MAP is the provisions of double taxation treaties that are similar to Art. 25 of the OECD MTC or to Art. 25 of the UN Model Double Taxation Convention between Developed and Developing Countries (both approaches have a lot of common in case of the MAP article). As a procedural mechanism, MAP should be used not for the dispute resolution on the basis of inconsistencies concerning domestic legislation but only for the dispute resolution in case of taxation not in accordance with the double taxation treaty: ‘... where a charge of tax has been made contrary both to the Convention and the domestic law, this case is amenable to the mutual agreement procedure to the extent only that the Convention is affected, unless a connecting link exists between the rules of the Convention and the rules of the domestic law which have been misapplied’¹⁸.

All double taxation treaties of Ukraine have provisions regulating MAP. Nevertheless, it doesn’t mean that all these articles share the same structures and formulations. For example, the double taxation treaties of Ukraine with Belgium, Denmark, Egypt or Estonia do not include the provision described in the second sentence of the Art. 25(3) of the OECD MTC. It provides the opportunity for the competent authorities of contracting states to consult together for the elimination of double taxation in cases not provided for in double taxation treaties themselves.

¹⁸ Ismer, R. (2015), Article 25. Mutual Agreement Procedure. In: *Klaus Vogel on Double Taxation Convention*. Eds. by E. Reimer & A. Rust. 4th ed., Vol. 2. Alphen aan den Rijn: Wolters Kluwer, p. 1741.

The situation has obviously changed with when the provisions of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) became effective in the relation between the relevant jurisdictions. In order to level the playing field in the attempt to provide the equal opportunities to the taxpayers, the developers of the MLI include the provisions in the second sentence of Art. 16(3) of the MLI that are similar to the norms of Art. 25(3) of the OECD MTC.

Despite the progress made due to the MLI, the exiting differences in the formulation and further interpretation of the provisions of double taxation treaties of Ukraine regulating MAP might create additional obstacles in the effective implementation of the relevant provisions of double taxation treaties. As it seems, it might be illustrated with the inclusion of the provision analogous to the second sentence of the OECD MTC into Art. 11(2) of the double taxation treaty between Ukraine and Cyprus signed on 8th November 2012 ('the competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation' i.e. the limitation for taxation of interest paid outside the source country). This provision was in the focus of the attention of the Odesa Administrative Court of Appeal in its abovementioned decision in the case No. 815/5010/17 dated 28 February 2018. The court confirmed that the absence of mutual agreement between competent authorities settling the mode of application of the limitations of Art. 11(2) of double taxation treaty with Cyprus should be the reason for denial in their application by the source country at all. Later, the District Administrative Court of Kyiv took the same position in its decision in case No. 826/10513/17 dated on 25th April 2019¹⁹. Taking into account the clear statements of para. 12 of the commentary to Art. 11 of the OECD MTC, the position of both domestic court does not seem well-grounded because the contracting states are 'free to apply its own laws and, in particular, to levy the tax either by deduction at source or by individual assessment'²⁰. In the opinion of Ioana-Felicia Rosca and Alex-

¹⁹ *Rishennya Okruzhnogo Administrativnogo Sudu mista Kyiv* [Decision of the District Administrative Court of Kyiv], case No. 826/10513/17, 25 April 2019. URL: <https://reyestr.court.gov.ua/Review/81428651> (Last accessed: 30.04.2021).

²⁰ OECD (2017). *Model Tax Convention on Income and on Capital. Condensed Version (as it read on 21 November 2017)*. Paris: OECD Publishing, p. 261.

ander Rust, there is no obligation for the competent authorities to enter into such mutual agreements dealing with either the mode of taxation (by individual assessment or withholding taxes) or the level of taxation (directly apply the limited tax rate or apply the full tax rate and refund later), together referred to as the 'mode of application'²¹.

4. Possible ways of the improvement of the map regulation in Ukraine

Based on the existing normative provisions regulating MAP in Ukraine, it seems that they might be amended as follows:

1. Exclusion of the competent authorities' right to deny initiating MAP in case where the taxpayer has previously entered into domestic legal procedures of complaining on the same basis in Ukraine.

Art. 108–1.4 of the Tax Code of Ukraine states that the competent authorities should refuse to accept the taxpayer's application related to MAP if such taxpayer has appealed based on the domestic legal order and on the same basis before the date of application. It should be noted that this approach is too restrictive for the taxpayer because it is possible to lose the right to initiate MAP if the courts or authorized authorities does not end in the final decision after three years starting from the day when the right to initiate MAP appears in taxpayers based on the provisions of double taxation treaties. Moreover, the analyzed provision of tax legislation might be criticized following the provisions of the OECD MTC. Para. 34 of the commentaries to Art. 25 of the OECD MTC prescribes that 'a taxpayer is entitled to present his case... to the competent authority of either State whether or not he may also have made a claim or commenced litigation under the domestic law of one (or both) of the [Contracting] States'²². Additionally, Art. 16(1) of the MLI clearly points out that the taxpayer's right to present the case for MAP

²¹ Rosca, I.-F. & Rust, A. (2020), Articles 10(2) and 11(2) of the OECD Model Tax Convention: Direct Applicability, Refund and the Competence of Competent Authorities to Settle the Mode of Application In: *Tax Treaties and Procedural Law*. Ed by G. Kofler, M. Land, P. Pistone, A. Rust, J. Schuch, K. Sies & C. Staringer. Amsterdam: IBFD, p. 123.

²² OECD (2017), *Model Tax Convention on Income and on Capital. Condensed Version (as it read on 21 November 2017)*. Paris: OECD Publishing, p. 440.

to competent authorities of involved jurisdictions should be guaranteed, irrespective of the remedies provided by the domestic law of those jurisdictions.

2. Exclusion of the taxpayer's right to commence court litigation after the mutual agreement between competent authorities of involved jurisdictions comes into effect.

Art. 108-1.6.4 of the Tax Code of Ukraine states that the taxpayer has the right to initiate court litigation in relation to the decision of the tax authority if the same taxpayer does not agree with the results of the mutual agreement made between competent authorities according to MAP. There is no clarity about the results of the collision between the court decision and the mutual agreement made on the basis of the MAP if they have the same taxpayer's request as the starting point and propose different approaches. The mutual agreement made on the basis of the MAP is one of the types of international treaties under Art. 3(4) of the Law of Ukraine No. 1906-IV dated 29.06.2004, having the title "On international treaties of Ukraine", so they are binding upon Ukraine and must be performed in good faith under Art. 26 of the Vienna Convention on the Law of Treaties of 23 May 1969. To avoid such potential clash between the international obligations and the court's judgments, it is proposed to exclude the taxpayer's right to commence court litigation after the mutual agreement between competent authorities of involved jurisdictions comes into effect but upon the clear consent of the taxpayer to the terms and conditions of mutual agreement between competent authorities. If there is no such taxpayer's consent, the mutual agreement should not be considered as concluded and, consequently, valid, and should not be implemented that might help to avoid the abovementioned clash and comply with the international obligations of Ukraine. In contrast to the existing approach, the proposed changes are also fully compliant with the provisions of para. 6.2 of the commentaries to Art. 25 of the OECD MTC²³.

3. Inclusion of special provision on the starting point of the 1095 days period to run limiting the taxpayer's right to initiate the MAP if the tax is levied by deduction.

²³ OECD (2017), *Model Tax Convention on Income and on Capital. Condensed Version (as it read on 21 November 2017)*. Paris: OECD Publishing, p. 431.

Art. 108–1.2.3 of the Tax Code of Ukraine states that the taxpayer has a right to apply for initiating MAP not later than 1095 calendar days since the day when the amount of tax is agreeing based on the results of tax audit. Such approach ignores the recommendation of para. 24 of the commentaries to Art. 25 of the OECD MTC²⁴. It states that the time limit for three-year period to initiate MAP begins to run from the moment when the income is paid if the tax is levied by deduction at the source (like in case of withholding tax in Ukraine). To avoid such non-compliance with the OECD standards, it might be recommended to include special provision in the Tax Code that the starting point for the 1095 days period to run limiting the taxpayer's right to initiate the MAP is the date of making payment to non-resident in case of withholding tax deducted at source in the territory of Ukraine.

5. Conclusions

Being in the focus of the attention of the international community due to the global campaign addressing BEPS, MAP is one of the key instruments to protect interests of taxpayers in case of taxation not in accordance with the provisions of double taxation treaties, especially in the atmosphere of existing uncertainty in international taxation after massive changes introduced by the MLI. Consequently, it is of utmost importance to provide effective domestic regulation of access to MAP for taxpayers and the implementation of its results but taking into account the limited resources of the tax authorities and the applicable international standards. In this case, the scarce practice of application of MAP by the Ukrainian taxpayers and public authorities has determined the existing of legal gaps and clashes in the provisions of the Tax Code of Ukraine introduced for domestic regulation of MAP and implementation of its results. Based on the results of the analysis provided by the authors, it is proposed to amend the provisions of the Tax Code of Ukraine as follows: 1) exclusion of the competent authorities' right to deny initiating MAP in case where the taxpayer has previously entered into domestic legal procedures of complaining on the same basis in Ukraine; 2) exclusion of

²⁴ OECD (2017), *Model Tax Convention on Income and on Capital. Condensed Version (as it read on 21 November 2017)*. Paris: OECD Publishing, p. 437.

the taxpayer's right to commence court litigation after the mutual agreement between competent authorities of involved jurisdictions comes into effect; 3) inclusion of special provision on the starting point of the 1095 days period to run limiting the taxpayer's right to initiate the MAP if the tax is levied by deduction. The proposed changes might help to improve the efficiency of MAP as an instrument of resolution of disputes on application of the provisions of double taxation treaties as well as compliance with the international standards in the area of international taxation such as the OECD MTC and its commentaries.

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Summary

Mutual agreement procedure (MAP) is an important instrument for resolving disputes on taxation not in accordance with the provisions of double taxation agreements. Nevertheless, its potential was not applied widely neither by taxpayers nor by the competent authorities in Ukraine. In 2020, the national legislator introduced changes to the Tax Code of Ukraine that might positively impact on the practice of application of MAP in Ukraine and make it more certain and comfortable for taxpayers and tax authorities. The taxpayers received the right to initiate MAP between competent authorities of contracting states in case of taxation not in accordance with the provisions of double taxation treaties. At the same time, the new legal provisions have few deficiencies in comparison with the international standards of international taxation included in the OECD MTC and its commentaries. Based on the results of the comparative analysis, the amendments to the Tax Code of Ukraine are proposed in the article.

Keywords: tax dispute resolution; double taxation; interpretation; international treaties; domestic implementation