

PREVIOUS REPORTS RELATED TO THE MODEL TAX CONVENTION

This section reproduces a number of reports that were adopted after the publication of the 1977 Model Double Taxation Convention on Income and on Capital and that have resulted in changes to the text of the Articles of the Model Tax Convention or the Commentary thereon.

While these reports provide a useful background to the Articles and the Commentary, it should be noted that, unlike these, they are not periodically updated and may therefore no longer reflect the views of the Committee on Fiscal Affairs.

The reports that are reproduced in this section are the following:

Transfer pricing, corresponding adjustments and the mutual agreement procedure (adopted by the Council on 24 November 1982).....	R(1)-3
The taxation of income derived from the leasing of industrial, commercial or scientific equipment (adopted by the Council on 13 September 1983)	R(2)-1
The taxation of income from the leasing of containers (adopted by the Council on 13 September 1983)	R(3)-1
Thin capitalisation (adopted by the Council on 26 November 1986)	R(4)-1
Double taxation conventions and the use of base companies (adopted by the Council on 27 November 1986)	R(5)-1
Double taxation conventions and the use of conduit companies (adopted by the Council on 27 November 1986)	R(6)-1
The taxation of income derived from entertainment, artistic and sporting activities (adopted by the Council on 27 March 1987)	R(7)-1
Tax treaty override (adopted by the Council on 2 October 1989)	R(8)-1
The 183 day rule: some problems of application and interpretation (adopted by the Council on 24 October 1991)	R(9)-1
The tax treatment of software (adopted by the Council on 23 July 1992)	R(10)-1
Triangular cases (adopted by the Council on 23 July 1992)	R(11)-1
The tax treatment of employees' contributions to foreign pension schemes (adopted by the Council on 23 July 1992)	R(12)-1
Attribution of income to permanent establishments (adopted by the Council on 26 November 1993)	R(13)-1

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Tax sparing — a reconsideration (adopted by the Council on 23 October 1997).....	R(14)-1
The application of the Model Tax Convention to partnerships (adopted by the Committee on Fiscal Affairs on 20 January 1999).....	R(15)-1
Issues related to Article 14 of the OECD Model Tax Convention (adopted by the Committee on Fiscal Affairs on 27 January 2000).....	R(16)-1

**TRANSFER PRICING, CORRESPONDING ADJUSTMENTS AND THE
MUTUAL AGREEMENT PROCEDURE**

(adopted by the OECD Council on 24 November 1982)

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INTRODUCTION

1. The topic briefly referred to as “corresponding adjustments” covers a broad area of problems which arise if the transfer prices or allocations of profit adopted by an enterprise in its dealing with an associated enterprise in another country are not accepted by the tax authorities of one or other of the countries concerned. If, in consequence, the prices or allocations are adjusted or are proposed to be adjusted for tax purposes in one of the countries, the question arises of whether or not a “corresponding adjustment” should be made in the other or whether the initial adjustment itself should be modified, with or without an appropriate corresponding adjustment in the second country. A further question arises as to what should happen if the two tax authorities cannot agree on this matter.

2. When drafting the 1979 Report on Transfer Pricing and Multinational Enterprises¹, the Committee on Fiscal Affairs, while recognising that the subject of corresponding adjustments was relevant to the subject of transfer pricing and created general problems for multinational enterprises, decided that it should not be taken up in the report at that stage (see paragraph 8 of the report). The Committee then took the view that the subject fell outside the boundaries of their task at the time. Moreover, it seemed possible that any discussion of the subject might call for a detailed consideration of the wording of existing provisions in the OECD Model Double Taxation Convention, not only those relating to corresponding adjustments but also those concerned with the mutual agreement procedures (Articles 9 and 25 of the 1977 OECD Model Convention, see Annex) and that this would call for separate study. In its Response to the 1979 Report, BIAC (the Business and Industry Advisory Committee to the OECD), which is generally responsible for representing the views of the private sector to OECD, felt, however, that this was too restrictive an approach and urged “that consideration of this subject be undertaken and concluded as rapidly as possible”.

3. In preparing the present report the Committee considered it necessary to review the experience gained to date in this field, both by tax administrations and by multinational enterprises (MNEs), in relation to the making of corresponding adjustments (or obviating the need for them) as well as to consider what possible changes in, or from, the existing arrangements might be

called for. They were greatly assisted by the evidence provided both orally and in writing by MNEs represented by BIAC and reference to this evidence is made in various parts of the report. Such references should not, however, be taken necessarily as an endorsement of their views.

4. The report is organised in the following way. After a brief summary of the situations in which the need for corresponding adjustments may possibly arise (Chapter II), the report reviews (in Chapter I) the experience of tax authorities in OECD Member countries in operating the provisions and procedures already available to them for the resolution of disagreements between them in transfer pricing and other matters arising under their double taxation agreements, and reviews also the problems arising for taxpayers in this context. In Chapter III the report deals with the particular suggestion that arrangements should be made for mandatory corresponding adjustments subject to an arbitration procedure, and in Chapter IV the report discusses a number of ways in which a more satisfactory use of the existing procedures might be made possible. In Chapter V the report summarises the main conclusions reached by the Committee in the course of its consideration of these matters.

Chapter I

THE PROBLEM OUTLINED

5. Where a transaction takes place across international borders between two associated enterprises, and an adjustment is made to the transfer price for tax purposes by one of the States concerned, the adjustment, if it increases the profits taxable in that State, may result in some economic double taxation. That is to say it may result in the taxation by the two States of the same profits or income in the hands of two separate but associated persons². More generally the same kind of result may occur where income which arises to an MNE and which is allocated by one State for tax purposes to a constituent part of that enterprise situated in that State is also allocated by another State to another constituent part situated in that second State. It is convenient to refer in this report simply, in most instances, to transfer pricing adjustments (or their “corresponding adjustments”) but the phrase should be read, where appropriate, as encompassing also such allocations of profits (or their re-allocation).

6. However, economic double taxation will not necessarily be a consequence of these situations. It will perhaps not result if, for example, an adjustment is made to a transfer price in respect of a transaction which has passed through a third associated person in a country with no tax on income or profits (a tax haven). In this case the adjustment may merely bring more profits into liability in the State making the adjustment. Another situation in which economic double taxation will not occur is where profits, although taxable in principle in both States, do not actually bear tax in one of them because of an exemption or relief provided by the law of that State. Thus, it may be mitigated or eliminated if the State of the parent company credits against its own tax on a dividend received from a subsidiary, not only any withholding tax charged on the dividend, but also the tax charged on the subsidiary's profits which underlie that dividend. Nor, of course, will double taxation result if the State imposing tax on the profits or income of the other associated enterprise makes an adequate corresponding adjustment downwards, either to the taxable profits of that enterprise or to the tax chargeable on it.

7. The need for tax authorities to make transfer pricing adjustments and corresponding adjustments is in principle avoided if MNEs consistently adopt,

for tax purposes, a transfer pricing policy based on the arm's-length principle and it is certainly not to be supposed that they never do this. It may be objected, however, that the admitted difficulties for tax authorities in the way of ascertaining the arm's-length price in a variety of circumstances may also be experienced by the MNEs themselves and that the genuine efforts of an MNE to follow the arm's-length principle may therefore not necessarily satisfy the tax authorities in all cases. Nevertheless, it seems clear that such efforts should at least limit very considerably the number of occasions on which adjustments by tax authorities are felt to be necessary.

8. So far as the tax authorities themselves are concerned, they too may hope to avoid the necessity of dealing with differences of opinion with other countries' tax authorities about transfer prices if they consistently follow the arm's-length principles set out in the 1977 Model Convention and the 1979 Report. In this context paragraph 15 of that Report may be of particular relevance. Here the point is made that "Since the assessment of an arm's-length price depends very often on careful judgement and the resolution of many, perhaps conflicting, considerations by negotiation between the tax authorities and the enterprise concerned, it follows that if the prices actually paid can be substantiated by acceptable evidence as being arm's-length prices there would be no justification for seeking to make merely minor or marginal adjustments to them for tax purposes. Similarly a tax authority should hesitate to disturb without good reason a pricing arrangement reasonably and consistently operated between associated enterprises if it is also reasonably and consistently operated in comparable dealings with independent parties."

9. However, if, for whatever reason, there is a difference of opinion between tax authorities about the need for a transfer pricing adjustment or its amount, then the questions whether the adjustment should be made, and if so, whether a corresponding adjustment should be made and what the amounts of the adjustment or corresponding adjustment should be, may well depend on the achievement of an explicit consensus between the two tax authorities. The achievement of this consensus may in many cases present no significant problems. But there is a variety of circumstances in which it may be difficult.

10. Thus, where there are no comparable prices for the same or similar transactions between unrelated persons, and the other evidence, if any, does not provide an obvious indication of the arm's-length price, then differences of opinion as to the proper arm's-length price are potential sources of difficulty.

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Divergences between the national laws of the relevant States, or even differences in their procedures may also give rise to difficulty.³

11. As a simple illustration one may take a royalty charged by a parent company in State B to its subsidiary company in State A which the tax authorities of State A decide is too high in relation to the royalty which would be fixed between enterprises dealing at arm's length. In that case the deduction of the royalty payment in arriving at the subsidiary's taxable profits in State A will be reduced (this may be defined as a "primary adjustment"). If State B, in spite of the fact that State A has made this adjustment, still treats the whole payment as an arm's-length royalty the whole amount will be taxed in State B as royalty income of the parent company and in effect therefore some part of the royalty may be taxed in both countries.

12. More complicated possibilities may, however, arise under the laws of some countries. State B, for example, may accept the correctness of the adjustment made by State A and regard only so much of the payment as a royalty as corresponds with the amount allowed as a deduction by State A, but may nevertheless treat the excess part of the royalty as a constructive dividend. If State A had the same approach then this might have the result that the excess over the arm's-length amount, instead of being payable without deduction of tax as a royalty, would as a dividend be treated as a payment from which withholding tax should have been deducted and State A might require payment from the subsidiary of the appropriate withholding tax. On the other hand State B might not be able to apply to the element of the payment treated by State A as a dividend any more advantageous rules applicable to dividends in State B or might be unable to give credit relief for the withholding tax levied by State A. In such circumstances, in order to recognise the fact that the excess of the actual royalty payment over the arm's-length royalty is nevertheless in the hands of the parent and not those of the subsidiary, appropriate "secondary" adjustments may be necessary if double taxation is to be completely relieved⁴.

13. Similar problems may arise with other types of transaction. Thus, to take a simple case, if a parent company has made a loan to a subsidiary abroad, the tax authorities in the subsidiary's country may adjust the interest rate if they consider that it is not an arm's-length rate. The tax authorities in the country of the lending parent company may perhaps not accept that the adjusted rate is an arm's-length rate — the two countries perhaps may have different views as to the particular financial market in which they should look for evidence of arm's-

length interest charges. A more complicated situation may arise if the country of the subsidiary takes the view that the loan is in reality a contribution to the subsidiary's equity capital and not an addition to its debt.

14. Payments of fees for services may also be viewed differently by the tax authorities of the country of the payer and those of the country of the receiver. Thus service fees from a subsidiary may be included in the taxable receipts of the parent company in full, while the tax authorities of the country of the subsidiary restrict the deduction allowable for the payment in arriving at the subsidiary's taxable profits on the grounds that it exceeds the arm's-length price, or possibly even refuse a deduction for the payment altogether on the basis that no real benefit has been conferred upon the payer.

15. Although the examples quoted above are mainly concerned with adjustments made to the tax liability of subsidiaries and the consequences of these adjustments for parent companies, the same sort of problems may, in general, also arise for subsidiaries as the result of adjustments made to the liability of parent companies or to the liability of other associated enterprises.

16. On the other hand, one type of problem may arise only in connection with companies which hold shares in other associated enterprises and receive dividends therefrom. If the country taxing the shareholder company gives a credit against its tax for the tax on the profits out of which the dividend is paid, then this obligation to give credit may be made more burdensome if the tax authorities charging the dividend-paying company do so on the basis of attributing more profits to it in relation to transactions with the shareholder company than do the tax authorities charging the latter — which they might of course do if they took a different view of the arm's-length price for those transactions.

17. Problems of double taxation resulting from the adjustment of transfer prices may also arise for MNEs because of their organisation and the arrangements which they make, in consequence, for intra-group transfers of goods and services, etc. and the payments for them. For example, if a cost contribution arrangement has been concluded within a group for research and development expenditure and if the tax authorities in the country of the parent company consider that the terms and conditions of the arrangement are not in line with the arm's-length principle, this could affect associated enterprises in several countries. Similar problems may arise in relation to costs incurred for

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the control, co-ordination and supervision of a group, for the provision of services “on call”, or for central advertising activities. There could be particular scope for such problems in the situation of highly-integrated multinational groups where different functions, for example, different stages of manufacturing or the R & D functions or the activities of distribution, marketing, selling, transportation, etc., are carried out by different entities in different countries. If, for example, the prices for particular semi-finished products are not recognised in one country, this may have consequences for the transfer pricing system practised in the group as a whole which may in consequence have to be completely reconsidered. In addition, matters may be complicated by the package-deals and set off arrangements, which are sometimes encountered in dealings between entities within MNEs.

18. However, although it is clear that differences of opinion about transfer prices or the allocation of profits or income may arise in a variety of circumstances, it should not be assumed that serious disagreements between tax authorities are an inevitable consequence of transfer pricing adjustments or the re-allocation of profits or income, or indeed that in practice the inability of tax authorities to arrive at acceptable agreed solutions to their differences of opinion is a common cause of substantial complaint. Nevertheless because such differences of opinion are possible, this report, in the paragraphs which follow, seeks to consider how they may be dealt with or prevented.

19. Similar problems may obviously arise in dealing with the attribution of profits on an arm's-length basis to a permanent establishment in one State of an enterprise of another State. The 1979 Report did not deal specifically with this situation but in general what is said in the Report in relation to associated enterprises is also relevant, *mutatis mutandis*, to the situation of an enterprise and its permanent establishments.⁵

Chapter II

EXPERIENCE WITH PROCEDURES CURRENTLY AVAILABLE FOR AVOIDING OR RELIEVING DOUBLE TAXATION

20. In practice it can be expected that in many cases any double taxation which might arise from transfer pricing adjustments made by one country will be readily alleviated in the other country without involving the tax authorities of the first country, either under domestic law or under provisions of a bilateral treaty corresponding to Article 9(2) of the OECD Model (which provides for relief in cases of economic double taxation) or in some other way.

21. However, it is undoubtedly necessary in a number of cases for there to be some discussion between the tax authorities of the two States concerned and, increasingly therefore, tax authorities are coming together for this purpose. Their discussions may be facilitated by provisions in their bilateral double taxation agreements on the lines of Article 25 of the Model Double Taxation Convention which provides a “mutual agreement procedure” which may be used by tax authorities as a means of seeking solutions to these and other kinds of problem within the scope of bilateral tax treaties. (This is sometimes known also as the “competent authority procedure” because the agreement which is to be sought under it is the agreement of the relevant “competent authorities” as defined in the relevant double taxation relief treaties.)

22. It may be helpful therefore to review here the application of Articles 9 and 25 in the light of the experience of tax authorities and taxpayers.

A. Corresponding adjustments

23. Article 9(1) provides the arm's-length rule for the tax treatment of transactions between associated enterprises. Article 9(2) provides that where one State taxes profits of an enterprise which feature also in the taxable profits of an associated enterprise in the other State and these doubly taxed profits are profits which would have accrued to the enterprise of the first State if the conditions which have been made between the two enterprises had been those which would have been made between independent enterprises, then the second State should make an appropriate adjustment to the amount of tax charged

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therein on those profits. This may be done either by recalculating the profits using the relevant revised price or by leaving the calculation to stand and giving the taxpayer relief against his own tax for the additional tax charged by the adjusting State.

24. In theory the adjustment to the arm's-length price under Article 9(1) should create no problems in arriving at the amount of relief due under Article 9(2), but as has been indicated above there are potential difficulties in practice. Moreover there are certain limitations to the scope of Article 9(2). In the first place, because of the requirement that the relief provided by Article 9(2) is to apply only where the doubly taxed profits are those which would have accrued to the first enterprise if it had been at arm's length from its associate, it must follow that, as stated in the Commentary (Paragraph 3), a corresponding adjustment is mandatory only if, and to the extent that, the relevant tax authorities agree with the adjustment of the price made by the tax authorities in the first State. The relief available under Article 9(2) may therefore not be complete if the two authorities have different views on what is the appropriate arm's-length price for a particular transaction. In addition, Article 9(2) makes no provision concerning secondary adjustments although the Commentary notes that nothing in the Article prevents such secondary adjustments from being made where they are permitted under domestic laws. Nor does Article 9(2) deal with the question whether there should be any obligation to make a corresponding adjustment within a specific period of time. Quite apart from this a number of Member States have made reservations concerning Article 9(2). This provision as it stands therefore does not provide, in practice, a complete answer to the problems with which this report is concerned.

25. In their comments on the 1979 Report, MNEs expressed the view that no topic was more directly concerned with the entire area of transfer pricing than the topic of corresponding adjustments and urged the OECD to set forth and endorse a mandatory system of corresponding adjustments binding on all Member countries. In their view, it was unsatisfactory to leave the matter as it stood. They feared that, as things are, taxpayers might be exposed to heavy burdens of tax and vulnerable to arbitrary and capricious pricing adjustments by examining revenue agents. They feared also that “the failure to deal adequately with the question of corresponding adjustments may raise the spectre of increasing cases of double taxation in non-OECD countries opting to follow the principles of the 1979 Report”.

26. It is fair to point out nevertheless that a number of OECD Member countries have demonstrated in their bilateral agreements, by articles on the lines of Article 9(2) of the Model Convention and in other ways, acceptance of the obligation to make corresponding adjustments, in the normal case, to relieve economic double taxation where they are satisfied that the original adjustment adequately reflects the arm's-length price.

27. It also seems fair to comment that the taxpayer must look primarily to the domestic tax appeal system of the relevant State or to the domestic law courts or other relevant domestic institutions for protection against arbitrary or capricious transfer pricing adjustments. Imposing a simple mandatory requirement on tax authorities to conform automatically to a transfer pricing adjustment made by the tax authorities of another country would not protect MNEs against arbitrary or capricious adjustment, although it might to some extent mitigate their total impact on an affected enterprise. But providing in this way that tax authorities must conform to the action of other tax authorities over whom they have no control would leave the conforming tax authorities themselves with no protection against any arbitrary or capricious adjustments which might be made in the first place by the other tax authorities concerned, and a provision of this sort is therefore clearly unacceptable for tax authorities.

28. If this expedient is therefore rejected, as it seems to the Committee that it must be, then there seem to be only two other basic possible alternatives. One is to oblige the tax authority, as Article 9(2) does, to make a corresponding adjustment but only to the extent that it can agree that the result of the original adjustment is to substitute the arm's-length price for the transfer price adopted by the taxpayer (so that if the overall result is to be satisfactory to the tax authorities as well as to the taxpayers there needs to be a voluntary agreement on this matter between the two tax authorities). The second is to compel both tax authorities, if they cannot agree, to submit the matter to a supra-national arbitration, and to abide by its decision. The problems involved in a system of compulsory arbitration are discussed in Chapter III below.

B. Mutual agreement procedure

29. As has already been indicated much difficulty in this area may obviously be avoided if the two tax authorities concerned can be brought together to discuss the issues and to seek to arrive at some agreement upon them. The Committee considers that tax authorities should therefore be

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encouraged to do this whenever it is appropriate and possible, and to do all they can in such circumstances to reach such agreement in order to eliminate double taxation as far as possible.

30. The amount of formality involved in instituting and pursuing discussions between tax authorities will vary from country to country. When less formal arrangements are possible, experience has shown them to be effective for preventing or relieving double taxation in many cases and the Committee does not suggest that the employment of these less formal arrangements should be discouraged.

31. The Commentary on Article 25 of the OECD Model Convention indicates, however, that “as regards adjustments to be made correlatively with the reinstatement of profits in the trading results of associated enterprises under the provisions of paragraphs 1 and 2 of Article 9, there is ground for considering that they may properly be dealt with through the mutual agreement procedure when determining their amount gives rise to difficulty”. Article 25 is formally therefore in point in this context.

32. Article 25 sets out procedures for three different types of mutual agreement. The first is dealt with in paragraphs 1 and 2 of the Article which apply to “taxation not in accordance with the provision of the Convention”: here the taxpayer himself initiates the procedure. The other two, which do not necessarily involve the taxpayer, are dealt with in paragraph 3: the first sentence aims at resolving “difficulties and doubts arising as to the interpretation or application of the Convention”; the second sentence refers to the elimination of double taxation in cases not otherwise provided for by the Convention⁶.

33. Competent authorities may obviously wish to discuss general problems arising in connection with adjustments to transfer prices, but so far as any particular taxpayers are concerned, the most important procedures are probably those in the first category — i.e. discussions about problems in particular cases initiated by the taxpayers concerned.

34. An important limitation of the procedure is that the competent authorities have only a duty to negotiate; they are not required to reach an

agreement, nor are they required to implement it when reached and, indeed, they may be unable to do so because of conflicting domestic law — such as that imposing time limits on the adjustment of assessments or on the making of refunds of tax. In the view of MNEs this is a serious weakness in the arrangements.

35. The Commentary to Article 25 of the OECD Model Convention recognises that competent authorities may need some outside help in reaching agreement and it suggests that they may agree to ask the opinion of an impartial third party in a particular case or, where it is a question of the correct understanding of the provisions of the Model Convention, to ask for the views of the OECD Committee on Fiscal Affairs. It does not appear that any use has yet been made of these facilities. Thus, while they remain a potentially valuable means of resolving differences between tax authorities there is no basis in experience for estimating how far they may be useful for this purpose.

36. MNEs practical experience of the operation of the mutual agreement procedure has been, moreover, that it is normally time consuming and uncertain in its results. It may be possible to reduce the amount of time involved in operating the procedure but it is difficult to see how to avoid uncertainty. The outcome of any discussions about a disputed matter must to some degree be uncertain and this is so whether the discussions are part of the process of seeking a negotiated settlement, or of securing a favourable decision, from a tribunal or from an arbitrator. MNEs indicate however, that an additional element of uncertainty arises because, in their view, tax authorities tend to lump together all current cases and to negotiate a general settlement on a very rough and ready basis. Thus, they fear the success of one taxpayer in his specific case may jeopardise the chances of another when States try to reach a global agreement for several open issues in a “broad-brush” approach.

37. This fear is perhaps a consequence of other features of the procedure which have also been criticised, *viz.* that the taxpayer himself has no rights in the matter beyond the right to initiate the procedure, and that he has in particular no right to be informed of the progress of discussions on his case or to submit his observation upon it.

38. Overall, MNEs consider that owing to the protracted nature of this procedure and the risks involved, most enterprises look at the mutual agreement procedure only as a last resort.

39. Without necessarily accepting, or accepting in full, the strictures of enterprises or other critics of the procedure, it is possible to recognise that the mutual agreement procedure is in certain respects a less than perfect instrument for resolving the problems which may arise in the implementation of double taxation agreements. It is clear that, as the Commentary to Article 25 already points out (in paragraph 42), “the conclusion of a mutual agreement depends to a large extent on the power of compromise which the domestic law allows the competent authorities”. It is perhaps necessary to underline the point that the legislatures of many countries may well be unwilling to give the tax authorities the discretion to decide the tax liabilities of individuals or companies by way of agreement with the tax authorities of another country, and that for this reason at least it is understandable that OECD Member countries have not been able to recommend more, in the Model Article 25, than that the competent authorities should be obliged to endeavour to reach agreement in the matters raised under the Article. For the same reasons, therefore, no change in this respect is recommended in this report. The possibility that particular bilateral conventions might contain provisions requiring the competent authorities to reach agreement is already, however, raised in paragraph 25 of the Commentary on the Article (that possibility of course remains open and is further discussed in Chapter IV).

40. Notwithstanding the criticisms which have been made of the mutual agreement procedure, it has been widely recognised as an efficient and flexible instrument in the interpretation, application and development of double taxation agreements and a suitable means for the elimination of both juridical and economic double taxation⁷. Certainly the experience of tax authorities within the OECD at least, is that, within its limitations, the mutual agreement procedure can be a very useful instrument in resolving difficulties arising in transfer pricing cases and that, up to the present, acceptable compromises have in practice nearly always been found. It does not appear that the experience of taxpayers has been significantly different.

Chapter III

POSSIBILITY OF MANDATORY CORRESPONDING ADJUSTMENTS SUBJECT TO ARBITRATION

41. It is recognised that the attention of tax authorities to transfer pricing practices and their ability to challenge particular prices has been developed only in comparatively recent years, and that it is possible that the numbers of adjustments made to transfer prices for tax purposes may increase in the future and increase accordingly the incidence of unresolved disputes between tax authorities about the appropriateness of the adjustments. It seems to the Committee, however, that it would be wrong to exaggerate this possibility; many transfer pricing adjustments have in fact been made and comparatively few have resulted in such disputes. Nevertheless the Committee recognises that the fear of this possibility may be at any rate one important element in the desire of the representatives of MNEs that additional facilities should be provided or changes made in the existing arrangements for resolving inter-governmental disputes about transfer prices, and in particular has given rise to the suggestions which have been made by those representatives that there should be instituted a system of mandatory corresponding adjustments coupled with a formal arbitration procedure for this purpose.

42. From the taxpayer's point of view, it has been suggested, a binding arbitration procedure would have a number of important advantages. If recourse to arbitration was required in the absence of a settlement within a specific period, the taxpayer would be provided with the certainty of a decision and the reduction of delay in bringing the problem before a deciding authority (which, quite apart from avoiding the expense associated with delay, would enable the matter to be dealt with while the relevant information was still comparatively fresh in the minds of those concerned and thus enable it to be dealt with more effectively). These perhaps are the main advantages envisaged. Other advantages which it is suggested could be expected are as follows. The arbitration proceedings themselves could be expected to be expeditious — the absence of any need for administrative or procedural rules, it is thought, would speed the decision-making process. An arbitration process — provided that it allowed the taxpayer a full right to present evidence and arguments — would give the taxpayer the opportunity to deploy all the relevant information and to

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correct any misunderstandings or misinterpretation of the information by the tax authorities in the course of the argument — taxpayers would thus not need to fear that the result of the process might be distorted by the lack of an opportunity to correct such errors of understanding. The problem could be put before impartial experts who would understand the commercial or industrial situation at the time when the price was fixed and would be particularly able from their experience to interpret the pricing information put before them. Because of this there would be less need for elaborate preparation of the case and the process would thus be less expensive, it has been suggested, than the preparation of a case for competent authority procedure or for litigation in the courts. In practice, the suggestion has also been made, arbitration decisions could be expected to be based less on a strict interpretation of national pricing rules and regulations than on what the arbitrator considered in the light of his experience to be a fair and equitable solution. Moreover, an arbitration system would obviate any danger that the merits of a taxpayer's case would be ignored and his claim abandoned by a tax authority as an expedient in order to achieve more successful results on behalf of other taxpayers.

43. The support expressed by enterprises for the idea of a compulsory arbitration procedure for the resolution of inter-governmental disputes in the field of transfer pricing has been echoed elsewhere. Although it appears that the idea may not be unanimously supported by MNEs in general, it seemed clear to the Committee that the idea had received sufficient support to indicate that it needed to be given serious consideration.

44. An instance of support given to the idea is provided by the favourable reception given to a Draft Directive of the European Communities by the Assembly of the Communities and by the Economic and Social Committee set up under the Treaty of Rome. This EEC Draft Directive was therefore an important constituent of the evidence before the Committee and to a certain extent guided their thinking on the matter. The Draft Directive would, in brief, provide a mutual agreement procedure between tax authorities designed to relieve any double taxation which might persist in the absence of agreement. The procedure would be initiated by the taxpayer and would require a decision within a certain period, failing which the matter would have to be referred, again within a certain period, to a commission consisting of representatives of the competent tax authorities augmented by members of an independent panel. The taxpayers concerned would have the right to present their case to the commission and argue it before them. The Draft Directive envisages that the

taxpayers and the tax authorities would then all be obliged to accept the decision of this commission. The Draft Directive remains as yet a draft however, and consequently it is not possible to draw any firm conclusions from it about how such arrangements would work in practice. It was, moreover, drafted for the particular circumstances of the member countries of the European Communities.

45. Nevertheless, a study of its details was instructive for the Committee. It indicated the problems which need to be solved in designing machinery of that sort and drew the attention of the Committee to a number of difficult questions. There can be no doubt that designing such machinery presents considerable problems.

46. There is the question for example whether it would in practice suffice to set up, as the EEC Draft Directive would do, a machinery which is merely an extension of the mutual agreement procedure — albeit an extension designed to produce a decision within a period of time. It has been argued that it is inappropriate for the tax authorities themselves to be part of the body which decides the issue, and that the taxpayer should be able to put the matter to a completely independent tribunal in which the tax authorities take no part. This approach, however, would leave the tax authorities in an odd situation — effectively a difference of opinion between two tax authorities would be litigated before an arbitrator on the initiative of a third party — admittedly a third party interested in the outcome but still, in the context, a third party and one interested, it is possible, only indirectly in the outcome. The system would need to provide adequately for the interests of both taxpayers and tax authorities and it is not easy to see how that could be achieved with this kind of arrangement.

47. Whatever system was adopted, there could also be the problem of how to deal with the taxpayer's rights of appeal to his own domestic courts. According to one view it would be inappropriate to allow the taxpayer the right to use the arbitration machinery as well as the domestic courts and thus perhaps have the opportunity of requiring the tax authorities to give him the benefit of whichever decision was most advantageous to him. As a practical matter, as well as to a certain extent one of equity, it could be strongly argued that before invoking an arbitration process the taxpayer should have exhausted or abandoned his domestic rights of appeal. As against this it may also be strongly argued that the taxpayer should not in any circumstances be required to give up his rights under domestic law, and indeed to require him to do so might well

create constitutional problems in some countries. A possible compromise might be to allow, as the EEC Draft Directive would allow, some countries to require the taxpayer to exhaust or abandon his domestic legal rights before seeking arbitration, while allowing other countries not to impose such a requirement. Even this solution, however, could leave some problems of balance between the situations of different national tax administrations engaged in an arbitration procedure.

48. Then there is the further question whether the arbitration should be final or whether there should be a further right of appeal — either by way of re-trial of the case, or by way of a consideration of whether the arbitrators carried out their task in a proper manner or whether they could reasonably have reached the conclusion which they did. For some the virtue of arbitration would be its finality, that is to say its certainty and the speed of the decision, and, for those, a further right of appeal would to some extent counteract this advantage and would certainly add to the potential expense of the procedure. But it may also be argued that arbitrators should be subject to some possibility of a check on their activities if taxpayers and tax authorities are to be adequately protected from arbitrary decisions. If a further appeal were accepted as appropriate the question would of course arise of which court should be responsible for hearing and deciding it.

49. Then there would also be the question of what should be the object of the arbitrators. Should it be to relieve double taxation? There is an important general consideration here which needs to be looked at first — if the taxpayer were to be sure of complete relief from double taxation there would be no likelihood that any manipulation of transfer prices on his part for a tax advantage could, if the tax authorities corrected it by a transfer pricing adjustment, result for him in a tax penalty. Some tax authorities would regard this as, at the least, overgenerous and provision might well have to be made to deal with this point.

50. If the relief of double taxation were to be the issue the problem would remain of how to deal with the situation where double taxation did not arise because one or other or both of the enterprises concerned were making losses. There would then be no question, at least immediately, of any double taxation. Of course, where the taxpayer concerned is able to carry taxes forward to another year, double taxation may arise in that year (just as there could be a shift backwards of double taxation if the taxes could be carried backwards). But

where the base can be carried forward it is likely to be difficult to foresee precisely whether double taxation will in fact arise. These problems might be avoided if the question for the arbitrators to decide was, instead, to be the amount of the transfer price — i.e. in the simplest form, what was the arm's-length price for the relevant transaction, or perhaps, in a more complicated form, what was the proper method to be adopted of arriving at the arm's-length price. But this, certainly in its simplest form, would narrow down, perhaps unsatisfactorily, the area of the arbitrators' consideration.

51. Connected with this question of what should be the object of the arbitrators is the question of the approach which they should adopt. Should they be mainly concerned to produce a pragmatic result, allowing them perhaps to do this by means of a simple compromise between the different views expressed, or would it be more satisfactory to require them to operate by analogy with a court of law, seeking to establish which of the claims put forward was the more correct or more in accord with natural justice? The adoption of the first approach might produce a result more quickly and perhaps less expensively than the second and, since the issues in such proceedings are likely to be very largely questions of fact and the relative weights to be given to different pieces of evidence, this could be seen to be a considerable advantage. However, careful consideration would need to be given to the effect which the adoption of such an approach might have on the ability of tax authorities to concede points to each other in attempts to negotiate solutions to such problems between themselves at an earlier stage. It would be most unfortunate if tax authorities feared to make such concessions because of a tendency on the part of arbitration simply to seek a middle way between the standpoints reached by the disputant tax authorities in their unsuccessful negotiations.

52. Then there are also questions concerning how the burden of costs should be borne and how the confidentiality of information produced for the purposes of the proceedings should be preserved.

53. These problems vary in difficulty and importance. They are cited not to suggest that an arbitration procedure is impossible but in order to show that the matter is one which would require much international consideration and co-operation if a satisfactory system were to be set up in which a large number of countries could participate, and that an arbitration procedure must inevitably therefore be a matter which tax administrations would have considerable

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hesitations about seeking to design even if it was recognised that there was an obvious and urgent need for one.

54. It is not in fact clear, however, that there is an obvious and urgent need for such an arbitration process.

55. At the same time it seems to the Committee that the setting up of such a scheme would involve an unprecedented surrender of fiscal sovereignty. Some Member countries have in fact made it clear already that they would find such a scheme quite unacceptable for this reason.⁸

56. It seems to the Committee that these are conclusive arguments against recommending such a scheme. Nevertheless, the case for an arbitration procedure has been pressed so strongly in some quarters that it seems necessary to expand the comment that the need for it has not been established. It is not in fact apparent that existing arrangements are working so unsatisfactorily that a new form of machinery is imperative. Indeed it seems at present that where there are double taxation agreements very few cases of transfer pricing adjustments lead to adjustments which give rise to unresolved disputes between the relevant tax administrations or leave the taxpayers suffering significant inequity. It has of course been argued that, up to the present, tax administrations have not in practice made a large number of transfer pricing adjustments but that the growing interest of tax authorities in the transfer pricing of MNEs increases the potential area for disputes of this kind. However, it does not follow that an increased interest by tax authorities will inevitably increase the number of disputes between tax administrations which cannot be resolved. This increase in interest in transfer pricing is paralleled by an increase in the interest of tax authorities in consultation and co-operation between each other which it may be hoped will enable them the more easily to resolve such difficulties as arise in this field. It may be hoped too that the 1979 Report will also help to engender a common approach by tax authorities to these problems, which in itself will reduce the occasion for disagreement between tax authorities.

57. It has also been argued that some problems do in fact arise where the tax authorities of one country take a different view of a transfer pricing matter from that of the tax authorities of the other relevant country, but the problems are not brought to the surface. The argument is that double taxation is accepted by the taxpayer, though unwillingly, in such cases because the existing

competent authority or mutual agreement procedures are seen as cumbersome or longwinded or unlikely, for one reason or another, to produce a useful result in a reasonable time. The comparatively small number of problems which in fact come to the surface by way of the mutual agreement procedure, it is argued, is therefore not a true guide to the seriousness of the problem. Factual evidence to support this view is obviously, however, difficult to identify, let alone quantify. It is certainly possible that some potential subjects for discussion under the mutual agreement procedure are not pressed by taxpayers because to do so would raise queries about other aspects of their international activities or would put in question the settlement of other aspects of their tax liability. But if such is the case it must be assumed that the overall result is satisfactory to the taxpayer. Possibly also in some cases the tax reliefs given to a parent company by its own domestic tax law in respect of foreign tax on dividends received from an affiliate or on the profits underlying those dividends, may mitigate the effect of a disagreement between the country of the parent and that of the affiliate about the allocation of profits from transactions between them and, as a result, persuade the parent company that it should not press as hard as it might otherwise press to get the disagreement resolved.

58. The suggestion has been made that if, in the last resort, problems which the mutual agreement system had failed within a certain time to solve could be put to a compulsory arbitration, more use might be made of the mutual agreement procedure and that in those circumstances either a different picture would be revealed of the extent of the problem, or the tax authorities would simply, because of the possibility of arbitration, be prompted to come to an agreed decision in more cases and to do so more quickly.

59. Notwithstanding these arguments, however, the fact remains that little evidence has been produced to show that in the absence of an arbitration system taxpayers are left in any significant number of cases to suffer inequity.

60. Thus the immediate or compelling need for an arbitration system remains, in the view of OECD Member countries' tax authorities, still to be demonstrated.

61. Moreover, the advantages claimed for an arbitration system are not unqualified. Thus, if it were an essential requirement that cases must be considered speedily, this might have to be achieved at the expense of a full and proper consideration of all the issues. The absence of administrative or

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procedural rules, if this were in fact to be a feature of an arbitration process, and a reliance on the arbitrator's broad general view of what seemed fair, though possibly an advantage in some cases, could in other cases give one or other of the parties the impression that a full opportunity to argue the case had not been allowed or that for some other reason justice had not been done. The opportunity to put matters before independent and impartial experts with experience in the particular field could certainly be useful in some cases, but in the most difficult transfer pricing issues it may well be the case that the difficulties arise because of the special situation of the taxpayer concerned (how, for example, to determine the value of a particular patent which is not readily comparable with any other) and it may not be easy to find an expert in the particular matter who is not also connected in some way with the relevant enterprise.

62. This is not to say that the advantages claimed could not be achieved to some extent but they might only be achieved by accepting some corresponding disadvantages.

63. Bearing in mind the considerations set out above, the Committee does not therefore, for the time being, recommend a compulsory arbitration process for the resolution of disputes between tax authorities about transfer prices or the allocation of profits for tax purposes between the different components of an MNE.

Chapter IV

POSSIBLE IMPROVEMENTS TO MORE SATISFACTORY USE OF EXISTING ARRANGEMENTS FOR AVOIDING DOUBLE TAXATION

64. It is, in consequence, a matter of some importance in this situation to look carefully at the criticisms which have been levelled at the existing arrangements provided in bilateral tax treaties for dealing with transfer pricing adjustments made by the tax authorities of a treaty partner country, and to consider how, if possible, these criticisms may be met and the system made more satisfactory.

65. In fact, although the Committee offers some comment and suggestions in this context in the paragraphs below, and makes a number of recommendations which ought, in its view, to improve the operation of the existing arrangements, it does not put forward any radical recommendations for change. The matter is, however, one in which practice is developing and it seems to the Committee that it might be kept under periodic review in the future.

66. Some of the criticisms which have been levelled at the existing arrangements for relieving or avoiding economic double taxation have been discussed already to a certain extent in Chapter II. The object of the following paragraphs is to go, in rather more detail, into the problems which would be raised in dealing with these and other criticisms, as well as to touch on a number of related items which have not already been mentioned.

67. But this discussion should be seen in its proper context. As has already been pointed out, there are a variety of ways in which tax authorities may without undue difficulty avoid or relieve the imposition of economic double taxation as a consequence of transfer pricing adjustments. There may, for example, be no difficulty in the one State about accepting a transfer pricing adjustment made by the other in a particular case and consequently no difficulty about using the adjusted price as the basis for the computation of tax liability under its own laws. If there is difficulty, the tax authorities may be able to come to an arrangement, under which the adjustment is modified by the State making it, so as to be acceptable to the other. In many cases the tax authorities will thus

come to a mutually satisfactory agreement by employment of the existing arrangements. Moreover, tax authorities will be governed in the making of adjustments or corresponding adjustments by the need to be able to defend their decisions before their own domestic courts or other appeal bodies, and this too should reduce the occasions for disputes with the taxpayer.

68. There are, nevertheless, two aspects of the existing arrangements which need to be considered. One is whether the existing provisions in the OECD Model Convention (Articles 9 and 25) and their bilateral equivalents are adequate or should be changed or expanded. The other is whether the procedures and operation of the Mutual Agreement Procedure as provided by Articles on the lines of Article 25 in bilateral agreements could be improved.

A. Corresponding adjustments

69. As noted earlier, it has been pointed out as a matter for regret by some critics that “secondary adjustments” are not provided for under Article 9. If double taxation is to be fully relieved it is clearly desirable in theory that where a transfer pricing adjustment is made in one State the relief provision should so far as possible take account of both the primary and the secondary consequences of the adjustment. The current absence, however, of any general consensus as to what secondary adjustments are permissible or how relief should be given to take account of them makes it difficult to suggest how this may be done and, in the absence of any indication that many serious problems arise in this area which in practice are not satisfactorily resolved, no change is recommended here. The Committee considers, however, that it would be useful to return to this subject at some time in the future when practice in such matters has developed further.

70. It is necessary to consider also the question whether Article 9 of the Model goes far enough in the obligation which it imposes on treaty partners to make a primary corresponding adjustment. As paragraph 3 of the Commentary on Article 9 points out “an adjustment is not automatically to be made in State B simply because the profits in State A have been increased: the adjustment is due only if State B considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm's length. In other words, the paragraph does not seek to avoid a double charge to tax which arises where the profits of one associated enterprise are increased to a level which exceeds what they would have been if they had been correctly computed

on an arm's-length basis. State B is therefore committed to make an adjustment of the profits of the affiliated company only if it considers that the adjustment made in State A is justified both in principle and as regards the amount". Clearly it would be unacceptable to commit State B to provide an automatic corresponding adjustment, whether or not it considered that the adjustment made in State A was justified in principle and amount, since this would be tantamount to requiring State B to give State A a blank cheque. (The Committee took the view moreover, that Article 9(2) did not in fact impose any obligation to match a corresponding adjustment where the original adjustment was made to correct the deliberate manipulation of a transfer price by the enterprise for the purpose of gaining a tax advantage.) Some possible protection for State B might be provided if the Contracting States were able to agree in some detail in their bilateral arrangements on rules about the way in which to ascertain arm's-length prices in particular cases — by for example agreeing on safe haven rules in specific kinds of case. In this way they might be reasonably assured that the result of accepting the other State's adjustments would be broadly equitable. Arrangements of this sort would be bound, however, to be a compromise and it would be difficult to devise them in such a manner that they did not conflict with the arm's-length principle itself. The Committee does not, therefore, recommend any change in Article 9(2) of the Model or in the Commentary on that Article.

B. Mutual agreement procedure

71. A second aspect of this enquiry must clearly be to what extent the mutual agreement procedure can be improved. Some of the criticisms, it will be obvious in the light of preceding paragraphs, cannot be met. There is no way of forcing the competent authorities to come to an agreed decision short of requiring them to submit to the decision of a supra-national authority and for the reasons already expressed this is not regarded as recommendable. Similarly they cannot otherwise be compelled to reach a decision by a certain time. But there may nevertheless be some scope for facilitating the reaching of agreement and for speeding up the process.

72. The aspects of the mutual agreement procedure discussed below concern in the first instance the resolution of specific transfer pricing cases. The extent and operation of Article 9(2) of the OECD Model Convention may be in point. But so may the extent and operation of Article 25. This is an area where some tax authorities feel that clarification may be desirable to enable

taxpayers and tax authorities to know more certainly what may be done in this context and it has therefore been the subject of consideration by the Committee.

1. Clarification of the scope of Article 25 of the OECD Model Double Taxation Convention

73. The mutual agreement procedure provided by Article 25 is concerned with actions of the Contracting States which the taxpayer considers may or will result in taxation not in accordance with the provisions of the Convention. Thus, under a bilateral convention containing an article on these lines, the question whether a mutual agreement procedure can be undertaken depends on whether the action complained about may, or will, result in taxation not in accordance with the provisions of the convention. The Committee has come to the following conclusions.

74. When a convention contains provisions similar to those of paragraph 2 of Article 9 of the OECD Model Convention, those provisions relieve economic double taxation of profits by requiring a State which has collected excessive tax, as a consequence of transfer prices in dealings with a company of that State, to make a corresponding adjustment to the profits of the company, insofar as they were unjustifiably high. To that extent, taxation initially imposed by that State is “not in accordance with the convention” and the taxpayer is entitled, under the provisions of Article 25, paragraphs 1 and 2, to present his case to the competent authority of the State of which he is a resident (see paragraph 9 of the Commentary on Article 25), within three years from the first notification of the most recent decision or action (cf. paragraph 17 of the Commentary on Article 25). The competent authority which the taxpayer applies to is under the obligation to approach the competent authority of the other State, if the objection appears to it to be justified and it is not itself able to arrive at a satisfactory solution. The mutual agreement procedure therefore provides competent authorities with an adequate legal framework for consultation when the difficulty in determining the profit is due to difficulty in reaching agreement on the appropriate transfer price. In fact, consultation in such cases is expressly provided for in the second part of the last sentence of Article 9, paragraph 2, which, by itself, allows competent authorities to consult directly. Even when paragraph 2 of Article 9 does not include the second part of the last sentence, the mutual agreement procedure, as provided for under Article 25, paragraphs 1 and 2, should apply.

75. The matter is less clear where the convention does not contain the equivalent of Article 9, paragraph 2. However, a number of countries have observed that, in substance, paragraph 1 of Article 9 does not, in itself, fulfil any necessary function, as it only formulates rules which already exist, in broadly similar language, in most domestic laws, which can be applied without conflicting with any provision of the convention, even where the convention does not contain any Article 9. Following this line of thinking, the inclusion of Article 9 (paragraph 1) in a convention would demonstrate the contracting parties' wish to cover economic double taxation in the convention. As a consequence, any economic double taxation arising from the adjustment of transfer prices would not be in accordance with — at least — the spirit of the convention, and would fall within the scope of the provisions of the mutual agreement procedure, under Article 25, paragraphs 1 and 2.

76. Some countries do not, however, share this view: according to a literal interpretation, they consider that, when Article 9 does not contain any paragraph 2, no provision in the convention imposes a requirement on the State which has included in its tax base profits unduly transferred to a company which is a resident of that State to revise its assessment in order to exclude such excess profits; taxation of such profits is therefore not contrary to the convention, and paragraphs 1 and 2 of Article 25 do not apply; strictly speaking, the taxpayer is accordingly not entitled to have his case reconsidered and he may not invoke the three-year time limit provided in Article 25, paragraph 1. Usually, such States, however, have the possibility of reconsidering a taxpayer's position, in case of economic double taxation, either on the basis of domestic provisions or by the exercise of discretionary power which some tax authorities possess to relieve the most severe cases. Such procedures are more flexible and do not always give to the taxpayers a formal right to submit claims; in practice, they help to alleviate double taxation in all cases when there is no doubt about the good faith of the companies concerned.

77. On the other hand, paragraph 3 of Article 25 of the Model would allow the competent authorities to consult about the elimination of double taxation in cases not provided for in the Convention and this may be sufficient authority, for at least a few countries, to consult on particular cases of transfer pricing adjustments.

78. Some States have to some extent clarified the issue in their bilateral agreements by providing specifically, in the text of the equivalent of Article 25,

that the mutual agreement procedure may be used for the resolution of problems of interpretation or application of the Convention related to transfer pricing. However, this is usually done in bilateral conventions containing provisions similar to Article 9(2) of the Model.

79. In order to avoid any doubt in cases where a convention does not contain provisions similar to those of paragraph 2 of Article 9, an additional paragraph should be inserted after paragraph 9 of the Commentary on Article 25 when the OECD Model Convention is next revised. The paragraph might read as follows:

“When the convention between two Contracting States does not contain rules similar to those of Article 9, paragraph 2 (as is usually the case for conventions signed before 1977) the mere fact that contracting parties inserted in the convention the text of Article 9, as limited to the text of paragraph 1 — which usually only confirms broadly similar rules existing in domestic laws — indicates that the intention was to have economic double taxation covered by the convention. As a result, most members of the Committee on Fiscal Affairs consider that economic double taxation resulting from adjustments made to profits by reasons of transfer pricing is not in accordance with — at least — the spirit of the convention and falls within the scope of the mutual agreement procedure set up under Article 25. States which do not share this view do, however, in practice, find the means of remedying economic double taxation in most cases involving *bona fide* companies by making use of provisions in their domestic laws.”

2. Procedural aspects

a) Time limits and the time factor

i) Time limits

80. An important difficulty in practice with the mutual agreement procedure seems to arise from time limits and the amount of time taken generally before agreement is reached.

81. It may be convenient to take first the question of time limits. The date beyond which no alteration can be made to a taxpayer's liability for a particular period may be reached in one country before the taxpayer can establish the need

for an adjustment corresponding to that made to an associate's liability in another country. However, there must obviously be some limit to the period during which claims to relief may be made. Tax liability must become final at some stage or there would be no certainty for the tax authorities or indeed for taxpayers. But the existence of such time limits and the fact that they vary from country to country does mean that in order to minimise the likelihood of unrelievable double taxation their potential impact needs to be borne in mind. Thus, if it is possible for a tax authority in one country to adjust a transfer price ten years after the end of the year in which the transaction took place and the tax authorities of the country of residence of the relevant associated enterprise have long ago finalised the computation of that enterprise's taxable profits, they may well be legally unable to make a corresponding adjustment.

82. The solution which is suggested in Article 25 of the Model Convention is that an agreement reached by the mutual agreement procedure should be implemented regardless of any time limits in the domestic law of the Contracting States. Thus if the mutual agreement procedure is invoked and results in agreement to make a corresponding adjustment it would be possible to do this regardless of any time limits in the relevant Contracting State, and the invocation of the mutual agreement procedure could overcome any difficulty arising in this way from the domestic time limits. If all countries could accept this, as some in fact do, then time limits would present less of a problem in this context. But a number of countries have reservations about overriding their domestic time limits in such a way.

83. Where a provision on these lines is not included in a bilateral treaty it would be necessary, in order to minimise the obstacles provided by time limits, for the discussions between the tax authorities to begin before any relevant time limits have run out and for those time limits to be effectively suspended until the discussions have been concluded. This in its turn indicates the need, in the circumstances, for tax authorities to consider the making of any transfer pricing adjustment at the earliest possible stage.

84. The suggestion has indeed been made that problems arising from time limits and the time lag between transactions and the adjustment of the relevant transfer prices might be avoided or at least reduced by the introduction of provisions into bilateral agreements which would prohibit the making of such adjustments after the expiry of an agreed period. This would be unacceptable to many countries. Tax authorities may need a long time to make the necessary

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investigations to establish the necessity and extent of an adjustment, and the indications even that an adjustment is necessary may only be brought to their notice late in the day. It would be difficult for many tax authorities to close their eyes to the need for an adjustment, however late in the day this need became apparent, provided that they were not prevented by their domestic time limits from making it. Nevertheless, where there was sufficient compatibility between the relevant time limits and other relevant elements (such as the procedure for imposing liability and the appeals system) in the tax structures of two Contracting States to ensure that this arrangement did not impose unequal sacrifices on one or other of the two States, it might prove to be a useful and acceptable expedient and some countries have apparently found it so. However, it does not seem to the Committee to be a suitable matter for a general recommendation.

85. Leaving these particular questions aside, the Committee does, however, recognise that it is desirable in principle to operate the system so as to minimise as far as possible the obstacles to the relief of double taxation which may result from the impact of time limits.

86. Article 25 of the Model Convention requires the taxpayer to invoke the mutual agreement procedure within three years from the first notification of the action complained of. This time limit does not itself create a great deal of difficulty (although some States consider that it provides too short a period for invoking the procedure while others have entered reservations against Article 25 because they regard it as allowing too long a period). The main difficulty in this context is in deciding what is the date of notification. As stated in the Commentary (paragraph 17), the time limit runs from the first notification of the most recent decision or action. It is desirable that tax authorities should take early steps to give the taxpayer clear formal notification of a proposal to make an adjustment if it seems that it is likely to provoke a request to another country for a corresponding adjustment.

87. The consideration of problems arising from time limits suggests in fact that, in order to minimise the possibility that time limits may prevent the mutual agreement procedure from effectively ensuring the relief or avoidance of double taxation, the procedure should be invoked at the earliest possible stage, that is to say as soon as an adjustment is seriously, even if only tentatively, proposed. If this were done, the process of consultation could be begun before any irrevocable steps were taken by either tax authority, with the prospect, therefore,

that there would be as few procedural obstacles as possible in the way of achieving a mutually acceptable conclusion to the discussions.

88. Not all competent authorities would, even so, wish to be involved at so early a stage in practice. A proposed adjustment may not result in final action and even a concluded adjustment may not trigger a claim for a corresponding adjustment. Consequently too early an invocation of the mutual agreement process may create unnecessary work.

89. Nevertheless, on balance the Committee recommends that competent authorities should be prepared to enter into discussions under the mutual agreement procedure at as early a stage as is compatible with the economical use of their resources.

ii) The time factor generally

90. On the more general point that the mutual agreement procedure may turn out to be an unsatisfactorily lengthy one, the Committee recognised that international consultations in these sometimes very complex matters could very often take a long time. The occasion for the relevant officials to meet must inevitably be restricted by the long distances which may have to be travelled, correspondence is often an unsatisfactory substitute for face to face discussions, there are language difficulties, differences in procedures and legal and accounting systems to be understood and taken into account and so on. The problem may also be complicated in itself and delays provoked because the taxpayer is slow to provide necessary information — obviously if he has invoked the mutual agreement procedure he will usually be ready to provide information bearing directly upon the point, but for a full understanding of the transfer pricing situation of an enterprise, and thus for a fully satisfactory solution of the problem, the tax authorities may need more than this, and MNEs are often slow to provide information of this wider kind. It would, on the other hand, be wrong to assume that delays were always a feature of the procedure. In practice the consultations often result in a settlement of the problem in a relatively short time and it may be hoped that developing experience in such consultations may itself speed matters for the future.

91. Nevertheless, the Committee agreed that every effort should be made by tax administrations to seek to avoid delays in these matters, and to improve their practice insofar as their resources permit.

92. One way of doing this would be to encourage face to face or telephone discussion between competent authorities, to supplement the written procedures, which may inevitably be rather lengthy. Such personal contacts can often more quickly establish whether an adjustment by one country is likely to give rise to difficulty for another and can often more quickly resolve any such difficulties, and, although in themselves they may obviously be expensive, they may, if used judiciously, settle complicated matters more quickly and thus less expensively in the long run. The Committee thus recommends the development of these forms of co-operation.

93. The OECD's work on exchange of information for the purposes of preventing avoidance and evasion should be useful for improving the co-operation of tax authorities for this purpose as well, both on a bilateral and possibly in suitable cases on a multilateral basis. It seems likely that an increased willingness on the part of tax authorities to solve transfer pricing problems (and others) in oral discussion with each other and to adopt as flexible an approach as possible to the search for compromise would remove much of the delay and difficulty of which the MNEs have complained. In this context the technique of "simultaneous examination" which is currently being developed by some countries may help in suitable cases. This is a process by which the tax authorities of two countries engaged in the examination of the tax affairs of associated enterprises separately within their own jurisdictions can co-ordinate their examinations, using the exchange of information provisions in the relevant double taxation agreement so as to establish more effectively and economically the facts about such matters as the transfer pricing of transactions between the enterprises. In the process, differences in approach which might lead to double taxation can be identified and discussed at an early stage and, it may be hoped, be more readily reconciled. Moreover, such arrangements will obviate the problems caused by one country examining the affairs of a taxpayer long after the treaty partner country has finally settled the tax liability of the relevant associated enterprise. (The question whether the technique is suitable for adoption in any particular case would need, however, to be carefully considered before embarking upon it.)

b) Delegation of powers and joint consultation

94. The mutual agreement procedure has generally been regarded as a matter of consultation between high level officials of the relevant tax

authorities. The reasons for this are sound; the fewer officials that are involved, the greater the likelihood of ensuring a consistent approach and the confidentiality of taxpayer information. Indeed, without the supervisory control of experts in a central position there would be some real danger of inconsistent decisions and, in consequence, of failure to achieve equitable results. Notwithstanding this need for central control there remains, however, the possibility of speeding up procedures by some delegation of the discussions to officials at a lower level (if the detailed examination of the taxpayers' transfer pricing is in fact in their hands) provided that the relevant exchanges of information are adequately controlled by the responsible competent authorities.

95. The experience of a number of countries shows that this can be a useful expedient once a mutual agreement procedure has been initiated between the competent authorities. For example, the following procedure has been practised successfully between some countries. The competent authorities in these cases have asked their case officers in the field to prepare a joint report on the case under investigation on, *inter alia*, the following lines: they are required to establish the facts and co-ordinate their findings so that both countries will base their decisions on the same facts and circumstances; they are then required to specify those questions of law (if any) on which the reporting authorities disagree, and, where problems of evaluation are involved, set up agreed lower and upper limits for the appropriate price, thus providing a range within which the competent authorities can reach a decision. In this way both delegation to lower levels and supervisory control by the central competent authorities have been satisfactorily achieved. This kind of procedure may not be appropriate in all cases but the Committee sees it as a useful technique which in the right situation may help to bring the competent authorities to a speedier decision. The Committee therefore recommends that in appropriate circumstances and under suitable controls competent authorities should be prepared to delegate some part of competent authority discussions on transfer pricing matters to the case officers concerned.

c) Taxpayer participation

96. It has been suggested that taxpayers should have the right to submit a request for the mutual agreement procedure to be instituted and that the request should not be unreasonably denied. Paragraph 21 of the Commentary on Article 25 of the OECD Model Double Taxation Convention makes it clear that this follows from the inclusion of an article on the line of Article 25 in a bilateral tax agreement. The Committee fully endorses this interpretation⁹. The Committee was, however, presented with no evidence to suggest that such requests were in practice being unreasonably denied.

97. It has been argued that the taxpayer should have a right to take part in the mutual agreement procedure, and that he should have the right at least to present his case to both competent authorities, and to be informed of the progress of the discussions, and, some representatives of industry have suggested, he should also have a right to be present at face to face discussions between the competent authorities. The object would be to ensure that there was no misunderstanding by the competent authorities of the facts and arguments which are relevant to his case. The suggestion is based on the view that the mutual agreement procedure is a process resembling litigation and that in litigation affecting his interests the taxpayer would have a right to be heard.

98. The mutual agreement procedure envisaged in Article 25 and adopted in many bilateral agreements on the OECD pattern is not, however, a process of litigation between the taxpayer and the competent authorities: for such disputes the domestic courts are the appropriate forum. The mutual agreement procedure is (unless there is specific provision to the contrary in the relevant law of the countries concerned) simply a process of discussion between the competent authorities in which they seek to explore the possibility of a solution to the relevant problem which can be accepted by all concerned. If it is only possible to find a solution which is acceptable to the tax authorities the taxpayer may still have the opportunity to achieve a solution more satisfactory from his point of view by invoking the domestic appeal systems of one or other of the States concerned. The taxpayer will not, however, necessarily have an interest in every case. It might well be, for example, that the essential issue in the discussions is simply one of which country should tax and which should give relief for the tax, with the result being effectively the same whatever happens for the taxpayer or, in the case of an MNE, for the taxpaying group. Formal rights for the taxpayer to appear and be heard in the discussion between the

competent authorities would therefore, in the view of the Committee, be out of place.

99. On the other hand if the procedure is to be useful and effective it would be sensible for the taxpayer to give the competent authorities all the information which is relevant to the issue and for the tax authorities to allow him every reasonable opportunity to present the relevant facts and arguments to them and to ensure as far as possible that the matter is not subject to misunderstanding.

100. In practice, it appears, taxpayers normally are given such opportunities, are kept informed of the progress of the discussions and are often indeed asked during the course of the discussions whether they can accept the settlements envisaged. The Committee recommends that these practices should be adopted as widely as possible. They would see no objection in principle moreover, in any case where this was convenient and appropriate and agreeable to both competent authorities, to allowing the taxpayer to present his case to them together at a joint meeting.

101. It has been pointed out that in many cases an MNE faced by the problems created by an adjustment of its profits in one State which has an effect on the tax liability of another part of the MNE in another State, has been able to resolve these problems by its own efforts. In fact, it seems likely that an MNE, when faced with an adjustment in State A which might require a counter-adjustment in State B, would thereupon examine the question of such a counter-adjustment under the laws of country B, make appropriate arrangements and seek to settle the case eventually by negotiations with the tax authorities of that State. There are obvious advantages in this procedure and Member country tax administrations would generally wish to encourage MNE's to seek to resolve their problems in this way before pressing for a formal mutual agreement procedures¹⁰.

102. They would no doubt be so encouraged if each tax administration were prepared to notify a resident affiliate of an MNE, at an early stage, of the intention to adjust its profits, and to discuss with the domestic entity of an enterprise which has received such a notification in another country the problems connected therewith, including the possibilities of a counter-adjustment. In this way a taxpayer which was part of an MNE would have time to inform the relevant affiliate in the group, or the headquarters of the group, which could then take steps to settle the case before irrevocable decisions were

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made in the adjusting country. The adjusting administration would then have less reason to fear that it would have to face a future demand for a mutual agreement procedure. This would facilitate procedures, both for the MNE and the administrations concerned.

103. The obverse of this problem, however, is that a failure on the part of an MNE in one country to advise its affiliate in another country that it proposes to accept an adjustment proposed by the tax authorities of the first country may leave the tax authorities of the second country in difficulty if they come somewhat later to the issue and disagree with the adjustments. They may have to consider refusing relief for any additional tax involved or asking the tax authorities of the first country to upset a settlement which they have made with their own taxpayer. It would help to avoid this situation if those tax authorities contemplating the making of a significant transfer pricing adjustment which might have this kind of consequence were to alert their partner tax authority in adequate time. But if the taxpayer wishes to avoid double taxation it must be his responsibility to take the necessary steps.

104. It should be clearly understood, however, that a taxpayer, in negotiation with the tax authorities of one country, cannot speak for tax authorities of another (unless he is specifically empowered to do so). It is not intended in these paragraphs to suggest that the taxpayer should in any way be empowered to act for a tax authority.

d) Package deals

105. The Committee has seen no evidence that taxpayers have in practice suffered injury as a result of “package deals” between tax authorities in the course of which complaints put through the competent authority procedure are settled, not on the merits of each individual case, but on the basis of a balance of interest between the competent authorities themselves. Nevertheless, since it is clear that this result is feared by taxpayers, the Committee records the view that competent authority cases should each be settled on their own individual merits and not by reference to any balance of the results in other cases.

e) *Unilateral information procedures*

106. It has been suggested that it would be helpful to taxpayers, enabling them to make more satisfactory use of the competent authority procedures, if competent authorities were to develop and publicise their own domestic rules or procedures in this field, so that taxpayers may more readily understand what they can do and how to go about it. This could also be helpful to tax authorities especially if they are faced with the possibility of a large or growing number of cases in which mutual agreement with other tax authorities may be necessary or desirable, possibly saving them the need to answer a variety of enquiries or work out procedures afresh in every case.

107. In publicising such rules and procedures it could, for example, be made clear how the taxpayer may bring a problem to the attention of the competent authority in order to start off a discussion with the other country's competent authorities. The publication could indicate the official address to which the problem should be referred, the stage at which the competent authority would be prepared to take the matter up, the nature of the information necessary or helpful to the competent authority in handling the case, and so on. It could be helpful also to give some indication of the way in which the competent authorities would normally approach the question of transfer pricing adjustment and corresponding adjustments and how they would normally handle such cases. The Committee recommends that this possibility should be explored unilaterally by competent authorities, and that, where appropriate, descriptions of their rules and procedures should be given suitable domestic publicity.

108. Unilateral rules or guidelines governing the operation of the procedure by one competent authority would not require agreement by the other competent authority, since they would be limited in effect to the competent authority's domestic relationship with its own taxpayers. However, it would seem appropriate to communicate such unilateral rules or guidelines to the competent authorities of the other countries with which mutual agreement procedures are usually entered into.

3. Other suggestions

109. A number of other suggestions which have been made for the improvement of the mutual agreement procedure under double taxation agreements should also be referred to in this report.

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110. One is that the procedure should not be used to review other tax matters not directly connected with the subject of the procedure. The Committee could not accept this as a general rule. Obviously it is easier for the mutual agreement procedure to be operated, both by taxpayers and by tax authorities, if the issues involved are narrowed down as far as possible. But it would be absurd if a request to a tax authority to initiate the mutual agreement procedure on one particular aspect of the taxpayer's affairs were to prevent the tax authorities from examining or exchanging information about other aspects of the taxpayer's affairs.

111. Another suggestion is that, if double taxation has occurred as the result of a court decision, this should not prevent the mutual agreement procedure from being operated or agreements which might be reached under it from being implemented. Again no evidence was produced to the Committee to indicate that this was a widespread problem demanding an urgent solution. The problem here is similar to that arising where time limits prevent the effective operation of the procedure, that is to say the objection in many countries to the substitution of the decision of officials for the domestic law as laid down in the statutes or as decided by the courts. If it is possible for agreements reached under the mutual agreement procedure to override the domestic law then clearly this will facilitate the operation of the mutual agreement procedure in some cases. But the Committee makes no recommendation on the point. The problem can, however, as with the time limit problem, be minimised perhaps if, supposing that the taxpayer concerned is not himself in a position to invoke the mutual agreement procedure, he can alert his associates in the other country, in adequate time, to the possibility that a court decision will affect a potential transfer pricing issue so that they can invoke the procedure at their end. Tax authorities may also consider it to be useful to alert the relevant treaty partner tax authorities if there is a significant chance that a court decision will provoke as a consequence a request for a mutual agreement procedure.

112. A connected suggestion which has also been made is that a taxpayer should not be obliged, as a condition of instituting the competent authority procedure, either to invoke the domestic remedies which are available to him or to have exhausted them. The Committee would not suggest that the legal remedies available to a taxpayer should be exhausted before his case was taken up for discussion under the mutual agreement procedure. Clearly this requirement would mean that in many cases there would be a possibility of

conflict between the outcome of the mutual agreement procedure and the outcome of the domestic appeal proceedings with the result that the agreement reached by the competent authorities could not be implemented. So long as the domestic appeal proceedings are not finalised and can be abandoned or concluded by a compromise settlement there should be no difficulty about allowing them to continue parallel with discussions under the mutual agreement procedure. If no agreement results then in each country tax authority and taxpayer each have an equal chance before the domestic courts. (The situation where binding arbitration proceedings were in point would be different: here there would be a question of two different bodies both considering the same issue, and both having power to make a decision binding on the tax authorities but possibly leaving the taxpayer free to choose the one most favourable to him.)

113. The suggestion that taxpayers should not be required to invoke their domestic remedies as a condition of invoking the mutual agreement procedure is not one which permits easy acceptance. In some countries it would be necessary for the domestic appeal provisions to have been invoked, and for the appeal to be kept open, in order that the mutual agreement procedures could usefully operate at all. The Committee agrees nevertheless that it is desirable to keep to a minimum the formalities involved in the operation of the mutual agreement procedure and to eliminate any that are really unnecessary.

114. It has been suggested also that the result of consultations under the mutual agreement procedure and the general rules applied in specific taxpayers' cases should be published provided that the confidentiality of the relevant taxpayers' affairs was safeguarded. This is a possibility which may be worth further consideration at some time in the future. At present it seems that most cases have to be decided so much by reference to their own facts that it would be difficult to publish the details without breach of confidentiality and that little useful guidance would be provided by their publication in any event. However, as experience is gained by tax authorities in these matters it might well be useful for competent authorities to include, in any material publicising their domestic rules, procedures and guidelines in this field, not only some indication of the broad principles adopted by the competent authorities in the actual cases which have come before them, but possibly some indication of the limits within which it is necessary for them to work because, for example, of the incidence of other countries' tax laws (including time limits) or because of the availability or otherwise of evidence of prices and perhaps some indication of the relative

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usefulness of the methods which have had to be adopted in arriving at arm's-length prices, etc. The Committee recommends that this possibility should be borne in mind.

CONCLUSIONS

A. General conclusions

115. a) *General comments on corresponding adjustments*
- i) The responsibility for minimising as far as possible the likelihood of double taxation arising from transfer pricing adjustments is in the first place that of the MNE itself, which should, at any rate for tax purposes, arrange its transfer prices to conform with the arm's-length principle;
 - ii) Nevertheless, the Committee recognises the desirability in *bona fide* cases of ensuring as fully as possible the relief of any double taxation, whether juridical or economic, which would follow from adjustments to transfer prices made to bring them into conformity, for tax purposes, with the arm's-length standard;
 - iii) It fully endorses, however, the view expressed in paragraph 3 of the Commentary on Article 9 of the OECD Model Double Taxation Convention that a State should not be committed to make an adjustment to conform to that made by another State except when it can agree that the original adjustment was correctly computed on an arm's-length basis¹¹;
 - iv) On the other hand, the Committee recommends that tax authorities should do all they can to reach an agreement on disputed transfer pricing adjustments or corresponding adjustments in order that double taxation should not persist where it could, by agreement, be eliminated.
- b) *The mutual agreement procedure*
- i) The Committee regards the existing mutual agreement procedure provided by Article 25 of the 1977 OECD Model Convention as being a useful and, in general, very effective machinery for resolving disputes between tax authorities in this field as in others, notwithstanding the criticisms which have been levelled at it;

- ii) The Committee recommends, however, for the avoidance of doubt, that it should be made clear, by an addition to the Commentary on Article 25 of the Model Convention, that this Article provides machinery to enable competent authorities to consult with each other with a view to resolving, in the context of transfer pricing problems, not only problems of juridical double taxation but also those of economic double taxation.

c) *Compulsory arbitration*

The Committee does not, for the time being, recommend the adoption of a compulsory arbitration procedure to supersede or supplement the mutual agreement procedure. In its view the need for such compulsory arbitration has not been demonstrated by the evidence available and the adoption of such a procedure would represent an unacceptable surrender of fiscal sovereignty.

B. Possible practical improvements to the mutual agreement procedure

116. The following summarises the proposals made by the Committee:

- i) The Committee regards it as important that the duty imposed on tax authorities, by an Article on the lines of Article 25, to set in motion the mutual agreement procedure if it appears to the competent authority that the taxation complained of is due wholly or in part to a measure taken in the other State¹² should be implemented as quickly as possible once the obligation is made clear, and that an application to set the mutual agreement procedure in motion should not be rejected without good reason;
- ii) The Committee endorses the view that the adoption, in bilateral agreements, of the last sentence of paragraph 2 of Article 25 of the Model Double Taxation Convention — *viz.* “Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States” — would eliminate a wide range of problems. It recognises, however, as does the Commentary on Article 25, that some States are not, on constitutional and other legal grounds, able to override the time limits in their domestic law. In general therefore the Committee recommends that every effort should be made by tax administrations to ensure that as far as possible the mutual agreement procedure is not in any case frustrated by

operational delays or, where time limits would be in point, by the combined effects of time limits and operational delays;

- iii)* The Committee in particular draws attention to the value, in transfer pricing matters, of ensuring as early and as full communication as possible on all relevant matters between tax authorities and taxpayers within their domestic jurisdiction and, across international frontiers, between the relevant associated enterprises themselves and the tax authorities concerned. Thus the Committee recommends that tax administrations should be prepared at as early a stage as possible to notify taxpayers of the intention to make a transfer pricing adjustment (and, where the date of any such notification may be important, to ensure that a clear formal notification is given as soon as possible);
- iv)* The Committee recommends that competent authorities should communicate with each other in these matters in as flexible a manner as possible, whether in writing, by telephone, by face to face or round the table discussion, whichever is most suitable, and should seek to develop the most effective ways of solving relevant problems by the use, where appropriate, of simultaneous examination procedures, the controlled delegation of functions to case officers, and such other techniques as are suitable for the purpose;
- v)* The Committee recommends that in the course of mutual agreement proceedings on transfer pricing matters, the taxpayers concerned should be given every reasonable opportunity to present the relevant facts and arguments to the competent authorities both in writing and orally, and, where this is convenient and appropriate and agreeable to both competent authorities, to do this in the course of a joint meeting of the competent authorities;
- vi)* The Committee recommends that the formalities involved in instituting and operating the mutual agreement procedure should be kept to a minimum and any unnecessary formalities eliminated;
- vii)* The Committee emphasises the view that mutual agreement cases should each be settled on their individual merits and not by reference to any balance of the results in other cases;
- viii)* The Committee recommends that competent authorities should, where appropriate, develop and publicise domestic rules, guidelines

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and procedures relating to the use of the mutual agreement (or competent authority) procedure.

C. Final remarks

117. The Committee proposes to keep under periodic review the question of how the effectiveness of the arrangements for corresponding adjustments and the use in this context of the mutual agreement procedure may be adapted to meet the needs of changing times or otherwise improved, and to return in the light of developing experience to the consideration of how secondary adjustments should be dealt with.

NOTES AND REFERENCES

1. Transfer Pricing and Multinational Enterprises: report of the OECD Committee on Fiscal Affairs, 1979, hereinafter referred to as *the 1979 Report* or *the Report*.
2. The term “economic” double taxation is thus contrasted with “juridical” double taxation which is the taxation by two States of the same income or profits in the hands of the same juridical person.
3. This was recognised in the Commentary on the 1963 OECD Model Double Taxation Convention (paragraph 4 of the Commentary on Article 25, last sentence). The point was not repeated in the Commentary on the 1977 Model Convention but it remains valid.
4. See paragraphs 5 and 6 of the Commentary on Article 9 of the 1977 OECD Model Convention where an example is given and it is noted that the making of secondary adjustments would depend on the facts of the individual case.
5. In this context, however, it is also relevant to say as in footnote to paragraph 7 of the 1979 Report, that whereas the principle of arm’s-length pricing is valid also for the taxation of permanent establishments, the considerations in this report need to be applied with care to the taxation of permanent establishments because of the special factors involved (for example, because of the limitations normally recognised on the acceptability for tax purposes of loan or royalty contracts between permanent establishments and the remainder of the enterprise of which they form part — see Commentary on Article 7 of the 1977 OECD Model Double Taxation Convention, and the report on the taxation of multinational banking enterprises contained in this publication).
6. These three provisions are sometimes described as the “specific case provision”, the “interpretative provision” and the “legislative provision” respectively (see: “The legal nature of the mutual agreement procedure under the OECD Model Convention”, *British Tax Review*, 1979, page 333, *et seq* and 1980 page 13 *et seq*).
7. For example, Resolution of the International Fiscal Association, September 1981.
8. It has been pointed out that tax authorities, by entering into treaties for the relief of double taxation, have already to some extent surrendered their taxing rights over taxpayers affected by the treaties. But the OECD Model Double Taxation Convention does not provide for decisions on matters of the tax liability of particular taxpayers arising out of the treaty to be imposed upon the tax administrations of the partner countries by a supra-national body.
9. Paragraph 21 of the Commentary on Article 25 reads as follows:

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“If, however, it appears to that competent authority that the taxation complained of is due wholly or in part to a measure taken in the other State, it will be incumbent on it, indeed it will be its duty — as clearly appears by the terms of paragraph 2 — to set in motion the mutual agreement procedure proper.”

10. Suggestions to this effect have in fact been incorporated in the guidelines of Germany and the United States.
11. The relevant passage reads as follows:

“3. It should be noted, however, that an adjustment is not automatically to be made in State B simply because the profits in State A have been increased; the adjustment is due only if State B considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm's length. In other words the paragraph does not seek to avoid a double charge to tax which arises where the profits of one associated enterprise are increased to a level which exceeds what they would have been if they had been correctly computed on an arm's-length basis. State B is therefore committed to make an adjustment of the profits of the affiliated company only if it considers that the adjustment made in State A is justified both in principle and as regards the amount.”
12. Paragraph 21 of the Commentary on Article 25 of the 1977 Model Convention.

Annex

**EXTRACTS FROM THE 1977 OECD MODEL DOUBLE TAXATION
CONVENTION ON INCOME AND CAPITAL**

Article 9
ASSOCIATED ENTERPRISES

1. Where:
 - a) An enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or;
 - b) The same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State;

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State - and taxes accordingly, profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

Article 25
MUTUAL AGREEMENT PROCEDURE

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of

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taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs. When it seems advisable in order to reach agreement to have an oral exchange of opinions, such exchange may take place through a Commission consisting of representatives of the competent authorities of the Contracting States.