



## Improving the Process for Resolving International Tax Disputes

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CENTRE FOR TAX POLICY AND ADMINISTRATION

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## IMPROVING THE PROCESS FOR RESOLVING INTERNATIONAL TAX DISPUTES

### I. Introduction

1. The dramatic increase in international trade and investments in the past years has had important implications for international taxation. Much of the attention has focused on adapting substantive tax principles to the new economic circumstances. Equally important, however, are the procedural aspects of international taxation. As the frequency of international transactions increases, so does the potential number of tax disputes involving several countries. The existing dispute resolution procedures developed in the Mutual Agreement Procedure (“MAP”) process in the Model Convention and incorporated in bilateral treaties have in general worked effectively, but are increasingly being put under strain. Both the volume of cases and the complexity of the cases with which the MAP has to deal have increased sharply. These developments are certain to continue in the future and thus it is timely to undertake a thorough review of the process for resolving international tax disputes.

2. Effective dispute resolution by the competent authorities (CAs) under the existing tax treaty procedures is an important aspect of the international law obligation of good faith implementation of a tax treaty as a whole. In particular, the MAP process requires that the CAs “shall endeavour” to resolve cases in a satisfactory manner. To carry out fully this obligation, every effort has to be made to reach a satisfactory resolution of the issues involved. Nonetheless, while the existing procedures generally are able to resolve outstanding disputes, there continue to be situations in which the cases cannot be satisfactorily concluded. For a number of reasons, it is likely that the frequency of these types of cases will increase. Moreover, the consultation held on 17 December 2003 showed that business had a number of concerns about the effectiveness of the MAP and were therefore reluctant to use it to resolve disputes. This is unsatisfactory as it will either result in unresolved double taxation or less satisfactory unilateral solutions.

3. An example of a less than satisfactory unilateral solution would be so-called “self-help” adjustments by the taxpayer. These can occur, for example, where following a transfer pricing audit on Company A ( a resident of State X) in respect of its transactions with Company B ( a resident of State Y), access to the MAP of the treaty between States X and Y is denied or where it would appear more efficient for the taxpayer not to seek MAP. Company B might include an adjustment in its subsequent returns in order to eliminate the double taxation arising from the audit of Company A thereby increasing the risk of an audit by State Y. Although such an adjustment might eliminate double taxation, it may not lead to taxation in accordance with the treaty in the absence of review by the CAs of States X and Y and would increase the compliance burden if two audits were carried out (i.e. in both States X and Y) in respect of one adjustment.

4. In short, the aim of this project is to ensure a fully effective MAP process that has the confidence of taxpayers and that therefore covers all aspects of the MAP from initial access to implementation of a mutual agreement. Such a MAP process should discourage adoption of unilateral solutions such as the ‘self-help’ solutions by taxpayers described in the previous paragraph.

5. Ensuring that cross border tax disputes are satisfactorily resolved is also extremely important in light of developments in other areas of the law. As non-tax barriers to trade and investment are eliminated,

tax issues assume greater and greater importance. Dispute resolution procedures are already being implemented in the trade context which results in a final and binding conclusion to trade disputes, and there will undoubtedly be pressure to extend the scope of those procedures to tax questions. The impact of unresolved tax disputes on trade and investment is undeniable, and any weaknesses in the treaty-based mechanism for tax dispute resolution invite the expansion of trade-related mechanisms.

6. In addition, providing an effective dispute resolution mechanism for tax disputes is closely connected to the basic OECD approach to its work. The OECD is a consensus organization and does not typically generate “hard law” but principles and guidelines. Working in this way, it is unavoidable that differences in interpretation and application will arise. It is thus an important responsibility of the Organization to make every effort to ensure that there is a well-functioning procedural mechanism to deal with these disputes when they do arise. This is true both with regard to relations between Member countries, but also, and in some ways more importantly, in relations between the OECD Member countries and Non-OECD Economies (“NOEs”).

7. Both the private sector and the governments involved have an important stake in improved dispute resolution techniques. From the private sector point of view, the possibility of unresolved disputes in matters governed by tax treaties can distort patterns of trade and investment and lead to increased administrative and compliance costs. Similarly, all governments lose when unresolved tax disputes inhibit effective tax administration.

8. In the light of these considerations, the CFA created a joint working group (“JWG”) composed of delegates from WP 1 and WP 6 to take forward the work on improving dispute resolution. The JWG has met a number of times to develop its proposals. In this context, it has solicited information from Member countries, held consultations with the private sector and had input in the project from NOEs in the context of the Global Forum on Taxation. .

9. The starting point for the JWG’s work was a detailed examination of the existing MAP process. It is clear that the MAP process will continue to be the basic mechanism for the resolution of international tax disputes. The existing MAP process has provided and will continue to provide a generally effective and efficient method for dealing with these issues. However, one of the main outcomes of the consultation with business was the perception by business that the MAP was a “black box” into which the taxpayer’s dispute disappeared and either no solution ever emerged, a solution emerged long after the event or the basis on which any solution had been reached was not explained or was not clear to the taxpayer. Accordingly, the JWG has identified a number of areas where the existing procedures can be improved and has highlighted situations in which obstacles to the use of the MAP can be eliminated. In addition, it remains the case that the existing procedures do not ensure that in all cases a final resolution of international tax disputes can be achieved. Thus the JWG has considered in some detail a range of Supplementary Dispute Resolution (“SDR”) techniques which can help to ensure that international tax disputes come to a satisfactory conclusion.

10. In order to prioritize its work, the JWG has identified a number of important issues which arise in the existing MAP process and in connection with SDR techniques.<sup>1</sup> As noted during the business consultation, a lot of the problems with ensuring an effective operation of the MAP are quite detailed in nature. In each case, the selected issues are analysed in detail and proposals are then made for improvements in the dispute resolution process. In some cases, this involves the development of solutions at the level of the OECD. This would include the establishment of a Manual on Effective Mutual Agreement Procedures providing guidance for both taxpayers and tax administrations as to appropriate

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<sup>1</sup> A number of other issues were considered by the JWG but it was decided to defer those issues until a later stage in the project and to focus on matters of more immediate importance in the work proposed here.

practices, as well as possible changes to the Model Commentary and to the Model Convention itself. At the national level, improvements could be implemented through adoption of best practice standards, publication and review of domestic MAP Guidelines and necessary changes in domestic law and treaty practice. The work to date has already benefited considerably from input from the business community, in particular the consultation held on 17 December 2003. It is proposed to continue to work intensively with the business community in developing solutions to these issues.

11. One of the important principles in any consideration of how to improve the effectiveness of MAP is that any such improvements should build upon the best features of MAP. This includes, in particular, the co-operation element of MAP, important not only as it may help resolve a particular case, but in that it can often be the basis of improved relationships between tax authorities more generally.

12. The issues which have been considered by the JWG are set out in the material that follows in a broadly chronological sequence, following the various steps in the MAP process. After a discussion of each issue, proposals for improvement are made. Some of the proposals are matters which countries could adopt currently in the first stage of this work (“**JWG current proposals**”). In other cases, possible solutions to existing problems have been identified but more detailed work and drafting on the solutions needs to be done (“**JWG proposals for future work**”). In other areas, issues have been framed but need to be developed further in the project before more detailed proposals for improvement can be made. (“**JWG proposals for future study**”). A summary of the JWG proposals is attached as Annex 1.

## **II. Improving the effectiveness of the MAP process**

### ***A. Improving access to MAP***

13. Both governments and taxpayers have an interest in facilitating taxpayer access to MAP, in ensuring that the taxpayer position and environment are understood, and that the taxpayer is treated as contemplated by the treaty. Thus it is important for the taxpayer to have as much information about the MAP process as possible and that potential obstacles which could discourage taxpayers from utilization of MAP be reduced or eliminated. The following materials consider a number of steps which could be taken to improve taxpayer access to MAP and to encourage taxpayers to use the MAP to resolve their cross-border tax disputes.

#### *i) Publication of MAP guidance for taxpayers*

14. The issue of ‘transparency’ has been identified in discussions with business, professionals and academics as one of particular concern. Increasing such transparency and information about how the MAP process functions is essential to improving access to the MAP process. While the Commentary to Article 25 of the Model Convention provides taxpayers with some basic guidance on the MAP, it can usefully be supplemented. Some States publish separate rulings, regulations and guidelines (collectively referred to as “guidance”) which explain their practice and procedures. The publication of such guidance constitutes an important tool in ensuring transparency and the effectiveness of the MAP. Such guidance can provide information regarding what amounts to the expectations that CAs have of taxpayers in MAP and as to what taxpayers may properly expect of the CAs in MAP. It can also address the positions which States have taken on issues of MAP where there is room for different views. Indeed, a recommendation to publish domestic rules or procedures related to transfer pricing MAP cases is made in paragraphs 4.61-4.63 of the OECD Transfer Pricing Guidelines.

#### **JWG current proposal:**

*Countries would review the guidance currently published on domestic rules and procedures for MAP to ensure that it meets the criteria for transparency set out in this note. Such guidance would include the*

*country position on both operational and technical issues. Countries that have not yet published any such guidance are strongly recommended to do so as soon as practicable.*

a) Country Profiles of MAP procedures

15. As one means to improve the transparency of the process, Country Profiles on Mutual Agreement Procedure (“Country Profiles”) submitted by OECD countries have been placed on the OECD website. This responds in particular to issues raised in public consultations for such a publication. NOEs (especially those economies that had stated their position on the OECD Model Convention) will be asked if they wish to provide the same information and include their profiles on the site.

**JWG current proposal:**

*The work on publication of Country Profiles is to be continued, country coverage to be expanded and the profiles are to be kept up to date and expanded to reflect future developments in the ongoing work. In particular, NOEs would be encouraged to participate in the process.*

b) Development of a Manual on MAP as a supplement to the discussion in the Commentary

16. The publication of Country Profiles is an important resource in providing more effective information about the MAP process. In addition, some more ‘international’ form of guidance could draw upon the work of individual countries, complement discussion in the existing Commentary and help to identify and broaden appropriate practices. It could be useful for both OECD Member countries and NOEs to evaluate their existing practices and to further develop them in the light of the ongoing work on this topic.

**JWG proposal for future work:**

*A Manual on Effective Mutual Agreement Procedure practices (“MEMAP”) would be developed for both tax administrations and taxpayers. The positions taken in the Manual would not be binding on Member countries but would reflect the analysis done in connection with the particular issue. The MEMAP would discuss appropriate practices and possible alternative approaches to issues considered by the JWG.*

*The individual issues which would be covered in such a Manual are discussed in detail in the relevant parts of this Report.*

c) Analysis of progress of MAP cases

17. Another key mechanism for increasing the transparency of the MAP process would be the development of some kind of ongoing analysis and publication of the progress in MAP cases in OECD Member countries (e.g. statistical data). It is recognized that such analysis would be quite sensitive and it would be important to establish uniform standards and criteria with respect to such analysis. It would be useful for such a publication to give a clear and accurate picture of the state of cases, the reasons for any apparent delay and other pertinent information. This would improve the transparency of the process and help to overcome some of the reluctance of business to use the MAP.

**JWG proposal for future study:**

*The possibility of developing some kind of analysis of the ongoing status of MAP cases in Member countries would be explored, including the type of information that would be disclosed.*

*ii) Requirements which must be fulfilled for taxpayer to initiate MAP*

18. There are a number of procedural and technical requirements for the taxpayer to be able to initiate a MAP. While these restrictions are necessary for the proper functioning of the MAP process, they also can act as a barrier to taxpayer access. To improve access, the content and method of application of these various necessary requirements should be made as clear as possible. There are a number of technical issues.

a) Time limitations in the Article, better definitions of starting/ ending of the period

19. According to paragraph 1 of Article 25 of the Model Tax Convention, the taxpayer must submit the request for a MAP within three years of the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

20. There would be benefits in further elaboration as to when this time period begins to run, and therefore finishes, such as, for example, in a self-assessment environment – what point represents the ‘notification’ referred to? For example, when should notification be considered to be given in a case where the source country levies a withholding tax contrary to the provisions of the convention but the double taxation only arises when the residence country later reassesses the taxpayer to deny a foreign tax credit, say four years after the withholding tax was originally levied?

21. While not likely to be an issue in most cases, if a common approach could be articulated or even if the views of different CAs were made readily available, that could avoid uncertainty in any cases where the exact date of notification becomes critical.

22. Many countries link the time limits for providing relief under Articles 9 and 25 to the time-limits applicable under their domestic laws for making adjustments or providing refunds, and in some cases, as the Commentary to Article 25 notes, this may mean that the treaty gives more than three years for the taxpayer to present the case. There is a related issue of whether domestic time periods should run during MAP, and similarly, whether the MAP period should run during the domestic proceeding undertaken before the MAP request is filed. While the first essentially depends on domestic law, the second raises the issue of whether treating MAP time periods for initiation as running during domestic proceedings, which may well last over three years, represents a good faith implementation of the Convention since it de facto means that after an unsuccessful domestic proceeding, the taxpayer may have (inadvertently) lost his access to MAP. It would be useful if these relationships could be clarified and, where there is in fact a danger that the MAP access could be lost during the domestic proceedings, adequate warning be given to the taxpayer.

**JWG proposal for future work:**

*Work would be undertaken to analyse time limitation requirements and discuss possible solutions in this regard, taking into account the differences in domestic rules. This work could result in the development of guidance on appropriate practices in the MEMAP with a view towards improving transparency on this issue and giving taxpayers an opportunity to protect their position. It could possibly also result in changes to the Commentary on Article 25.*

b) “Probability” of taxation not in accordance with the Convention (including in self-assessing systems)

23. As noted by paragraph 12 of the Commentary, to set the taxpayer-initiated MAP action in progress the taxpayer needs only establish a risk which is not merely possible but probable that the actions of one or both of the Contracting States would result in taxation not in accordance with the Convention.

24. The key is that the potential taxation contrary to the Convention must not be merely a hypothetical possibility, but a “practical probability”. Because this issue involves some fine judgments, there appears to be room for the Commentary to elaborate further on what constitutes a “practical probability”, perhaps including noting that in borderline cases, it is appropriate to give the benefit of the doubt to the taxpayer.

25. There are sometimes related issues about the point in time when the taxpayer is able to know that the opportunity to initiate MAP has first arisen, and whether there are guidelines or other possibilities that can help deal with situations where the taxpayer may not know about the probability of double taxation until a considerable part of the period for initiating MAP has elapsed (see example at paragraph 20 above of a withholding tax payment on which a foreign tax credit is later denied).

26. In particular it could be made clearer that the ‘practical probability’ approach does not mean that the taxpayer need prove this to a 51% probability, for example. There could also be some clarification about at what point of time the issue of the probability of taxation arises in a self-assessment case, whilst recognising that this may vary according to the characteristics of particular self-assessment systems.

#### **JWG proposal for future work:**

*Changes in the Commentary would be developed dealing with the “probability” of taxation not in accordance with the Convention and giving guidance as to how to apply this requirement, including what can be done to ensure that the taxpayer is aware that the time period has begun to run.*

*The MEMAP would also include a discussion of the issue of “probability” of taxation not in accordance with the Convention.*

c) Circumstances in which a taxpayer can be excluded from MAP, tax avoidance transactions, penalties etc

27. In some cases, notwithstanding paragraph 1 of Article 25, countries refuse to enter into the mutual agreement procedure where they consider that the relevant taxpayer has engaged in fraud or certain kinds of tax avoidance in relation to the case for which MAP is sought. A complication is that different States take different views of when the test is met.

28. As in many cases, this concern, the response and its practical impact, are best identified and discussed during the actual negotiations of a treaty. However, it would be useful to have a discussion of the pros and cons of various possible positions and attempt to develop appropriate practices and recommendations in this regard. One view that should be considered is that, in the absence of a special provision, there would be no general rule denying perceived abusive situations going to MAP. The underlying facts which may show that a claim is abusive or the like under applicable tax law may be relevant to the questions of whether there has been taxation in accordance with the Convention (and therefore whether the taxpayer’s claim appears justified). Domestic anti-avoidance law may also operate consistently with the Convention, as recognised in the Commentary to Article 1, for example. The approach of the EU Convention, which denies access to that process in the case of “serious penalties” could also be considered. On another view, any abuse will already have been dealt with under domestic provisions, e.g. penalties, and it would not be desirable to further penalise the taxpayer by refusing access to the MAP so that double taxation arises.

#### **JWG proposal for future work**

*The circumstances in which a taxpayer should be denied access to the MAP would be analysed together with a discussion of possible appropriate practices in this regard, taking into account the*

*differing domestic law circumstances in different countries. This analysis would be reflected in the MEMAP, and, if it were thought necessary, in the Commentary to Article 25.*

d) Access to MAP effectively blocked

29. One related issue that arises in consultations with business and their advisers concerning taxpayer access to MAP is that access to MAP is sometimes effectively ‘blocked’ while, at least in some cases, being formally available. Examples that have been given have included:

- Audit officials concluding settlements with taxpayers that were conditional on the taxpayer giving up the right to invoke the MAP;
- Interaction with internal administrative appeals procedures;
- Domestic law restrictions on both CAs meaning that neither party has the freedom to negotiate;
- “No-fault” or other administrative penalties being used to block access to MAP;
- Lack of access to MAP for correlative adjustments made under a self assessment system (adjustment not made by administration, but by the taxpayer); and
- Refusing access to MAP where a unilateral APA was concluded with the taxpayer on the same issue.

30. Guidance on these issues as a part of this project would be of value, as at least in some cases, such actions or situations could be said to point to a lack of good faith implementation of the treaty obligations. Such ‘blocking’ of access to MAP may also have the effect of encouraging taxpayers to take ‘self-help’ measures (see paragraph 3 above). On the other hand, there may be legitimate issues of domestic procedure involved in some situations.

**JWG proposal for future work:**

*The circumstances where domestic law procedural requirements or administrative practices effectively block taxpayer access to MAP would be analysed together with a discussion of appropriate practices in this regard, taking into account the differing domestic law circumstances in different countries. This analysis would be reflected in the MEMAP.*

*iii) Eliminating other barriers to taxpayer initiation of MAP*

31. The previous material has discussed a number of issues which may make it difficult for the taxpayer to access the MAP process. In addition to these questions of access, the following material discusses some issues, which technically relate to the actual conduct of MAP once it has started, but which may have a significant effect in discouraging taxpayers from even initiating MAP.

a) Suspension of tax collection during the MAP process

32. In some States, a MAP will not be commenced unless and until payment of the tax obligation has been made. In other cases, MAP can start but tax collection is not suspended. Such a collection of tax during MAP cases will in most instances impose temporary double taxation on the taxpayer whilst the MAP is in progress because the same profits have been subject to tax in both jurisdictions. As a practical matter, it also creates an issue of liquidity for the taxpayer.

33. It is recognized that country practices may differ here but the question could be raised as to whether the obligations in respect of good faith implementation of the MAP obligation have been met if the taxpayer is forced to pay the unrelieved tax as a condition for entering into the MAP process. To the extent that ultimate collectibility was an issue for the government, it would be possible, consistent with principles of proportionality, to provide for some sort of bond or other security procedure in lieu of payment during the MAP process. Some business representatives have suggested that a “clearing-house” should be set up whereby the taxpayer would pay the tax in dispute to the clearing-house which would distribute the tax to the appropriate tax authorities once the dispute has been settled under the MAP.

**JWG proposal for future work:**

*An analysis of country practices concerning the suspension of collection of tax during the MAP process would be made and an attempt to reach a consensus position that alternative methods of ensuring collection and otherwise protecting government interests could be developed. The outcome of this work could be included in the MEMAP and, to the extent deemed appropriate, in the Commentary.*

b) Suspension or remission of interest and penalty charges during the MAP process

34. These issues relate in some ways to the suspension of tax collection issue, but have some distinct features. Where MAP is initiated before the notice making a tax bill due and payable has issued, there is a good case for arguing that the accumulation of interest charges should be suspended for at least such of the time taken to settle the issue as is not due to the taxpayer’s failure to provide information in a reasonable time. In other cases, there seems less justification for suspension of interest charges, particularly if the taxpayer has had ample opportunity to seek MAP on the point before this time.

35. Another issue is whether interest should be suspended or remitted if there is offsetting interest paid on any overpayment in the other country. Similarly, there is the question of what consideration should be given to the tax treatment of the interest (taxed or deducted) in the other country.

36. MAP is not an appropriate way to try to harmonise divergent domestic policies in this area, or to match payments to one country with repayments by the other, but guidance could once again have a useful function, not just in extreme cases where failure to suspend or remit showed a lack of good faith implementation of treaty obligations but more generally.

**JWG proposal for future work:**

*An analysis of country practices concerning the suspension or remission of interest and penalties during the MAP process would be made and an attempt to reach a consensus position as to whether and when the suspension of interest obligations and penalty payments is appropriate could be developed. The outcome of this work could be included in the MEMAP and, to the extent deemed appropriate, in the Commentary.*

***B. Obstacles to the functioning of the MAP process***

37. This part of the Report examines the impact of obstacles that may not prevent initiation of MAP but may seriously impede the actual conduct of the proceedings, and the implementation of the MAP agreement. They involve some fundamental issues in the structure of the MAP process and in the relation of MAP to domestic law and other treaty articles.

*i) CA may lack the necessary legal authority to conclude and implement MAP agreements*

38. As the MAP procedure is typically a special treaty-based procedure falling outside the domestic law, the Contracting State must ensure that the CA clearly has sufficient legal authority to enter into mutual agreements and to ensure they are implemented. The CA plays a vital role in ensuring a good faith application of the Convention. The role needs to be clearly recognized and understood in this context – the CA is not there to protect the revenue of their home country regardless of the correct interpretation of the treaty or, for example, to defend audit adjustments not soundly based on the applicable legal principles. Otherwise there is a risk that the State will not meet its treaty obligations.

39. Any significant limitations to those powers known at the time of negotiation of the treaty should be discussed at that time. That may not provide sufficient transparency in individual cases, however - a record of such discussions will not usually be publicly available, so that it is preferable for the sake of transparency and in the event of litigation, that any agreed limitations should find some public expression, such as in any explanatory material accompanying the treaty, its implementing legislation or administrative instructions. For example, taxpayers should know in advance of making any claim for MAP that Country X will not discuss issues A, B and C with Country Y under the MAP of their bilateral treaty.

**JWG current proposal:**

*Countries would review the legal authority of the CA and clarify in their Country Profiles the extent of the CA authority and any specific limitations on the issues that can be subject to the MAP.*

**JWG proposal for future work**

*An analysis of legal authority necessary to conclude and implement MAP agreements would be made and that analysis would be reflected in the MEMAP with the recommendation that all countries grant the CAs the necessary authority for the MAP process to operate effectively.*

*ii) Relation of MAP to other treaty articles*

40. Paragraph 8 of the OECD Commentary on Article 25 raises some of the issues of interaction with other Convention provisions, and makes clear that a central issue about the relationship between Article 25 and the rest of the Convention concerns its relationship with Article 9 (Associated Enterprises). In particular, Article 9(2) itself contains a mechanism that enables a “corresponding adjustment” to be made in one Contracting State to resolve double taxation following a transfer pricing adjustment made on an associated enterprise in the other Contracting State. The Commentary to Article 25 specifically addresses the relationship of Articles 9 and 25 (including where there is no equivalent to paragraph 2 of Article 9) at paragraph 10:

“... most Member countries consider that economic double taxation resulting from adjustments made to profits by reason 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.”

41. However, despite the discussion at paragraphs 8-10 of the Commentary on Article 25, there have still been problems with whether the MAP can still be applied where States do not include Article 9(2) in their bilateral treaties. It is worth clarifying the relationship between the “corresponding adjustments” of Article 9(2) and the MAP to make clearer that the MAP is not dependent on the existence of Article 9(2) in the particular bilateral treaty.

### **JWG proposal for future work:**

*The Commentary to Article 25 would be clarified to indicate the circumstances in which the MAP can be applicable in situations involving corresponding adjustments.*

42. In addition, there might also be cases where the current OECD Commentaries can be amended to reflect the fact that sometimes the need for MAP can be avoided for “conflict of qualification” type disputes because double taxation is avoided by one State or the other giving credit for taxes paid in the other state, under the type of approach taken in the OECD “Partnerships Report”.

43. An example would be in relation to the ‘special relationship’ provisions in the Interest or Royalties Articles. Commentaries of these Articles could be amended to suggest that as an alternative to taking MAP action where different States treat excess amounts as taxable under different treaty articles ( as a result of the legitimate treaty interaction with domestic law) a solution could be found through an interpretative approach based on the analysis of the Partnerships Report.

### **JWG proposal for future work:**

*Subsequent revisions to the Commentary to substantive treaty articles may point out that in some circumstances application of the appropriate interpretation may be able to avoid the necessity of recourse to MAP, whilst leaving open the possibility of still using MAP where this is not possible.*

#### *iii) MAP and domestic law ‘constraints’*

44. The relationship between MAP and domestic law is a complex issue but is a crucial aspect of the practical application of MAP. This issue may arise when a MAP is initiated, when it is processed or after a decision has been reached and the mutual agreement has to be implemented.

45. Domestic law limitations to initiating a MAP have already been noted (see paragraph 29 above). Other domestic law constraints may prevent an agreement being *reached* by the competent authorities. The following are typical situations where this issue could arise:

- A state takes the view that no agreement can be reached under MAP while the same issue is actively being pursued under its domestic law dispute resolution mechanism, e.g. through litigation concerning the taxpayer involved in the MAP or some other taxpayer. Whilst this view in itself is compatible with the provisions of the Convention, its implementation can create difficulties as discussed in paragraph 31 of the Commentary on Article 25.
- A state takes the position that domestic law rules are not specifically overridden by the provisions of the treaty and, as a result, its competent authority considers that it does not have the legal authority to reach a satisfactory solution that would differ from domestic law. A specific case is that of time limits: a number of countries do not include the second sentence of paragraph 2 of Article 25 in their treaties and condition the implementation of mutual agreements to their domestic time limitations, which prevents them from agreeing to otherwise appropriate solutions that would force them to ignore these limitations.
- A court decision in a particular case has been rendered in one state (concerning the taxpayer involved in MAP or some other taxpayer) and the competent authority of that state considers that there is no legal authority to agree to a different solution of that case in the context of MAP.

- There is a judicial or statutory interpretation of a treaty rule in one State which is not shared by the other State and the competent authority considers that there is no legal authority to agree to a different interpretation under the MAP procedure.

46. These issues can also arise at the time of implementing a solution that has been arrived at under the MAP although one would expect that the competent authorities would not agree to a solution which they would know in advance that they could not implement under their domestic law.

### **JWG proposal for future work:**

*Country issues concerning the relationship between domestic law and the MAP process would be analysed and addressed with a view to allowing the MAP to operate to the fullest extent possible, taking into account the possible constitutional and other legal limitations in the domestic legal systems. The outcomes of this work could be reflected in the MEMAP and/or in changes to the Articles or Commentary of the Model Tax Convention.*

### **C. Carrying out the MAP from the government point of view**

#### *i) Development of processing time frame for steps in the process*

47. Although MAP is generally considered to be an effective mechanism to resolve international tax disputes, it is often viewed by taxpayers as a shortcoming of MAP that it provides no time frames, even illustrative ones. To respond to this concern, some OECD countries have developed ‘processing time frame standards’ for the MAP, which indicate appropriate deadlines for the different stages of a MAP case. The adoption of processing time frames can accelerate the MAP and enhance transparency. An illustrative time frame of MAP is shown in Annex 2.

48. It would be impossible to set a time limit suitable to all cases, because the time needed to process a case varies depending on a number of factors, e.g. the complexity of the case and the co-operation of the taxpayer. So ideally the estimated time frame should be established on a case-by-case basis. However, based on past case-processing data, an indicative time frame for completing cases may be established and published as part of taxpayer guidance. Further, some OECD countries have established target time frames of MAP with other treaty partner(s), which would have benefits for further enhancing the effectiveness of the process. Also, in addition to, or instead of, publishing an indicative time frame, some OECD countries periodically release relevant statistical information on MAP, such as the number of applications, pending cases, cases settled and the average duration of a case. Such information would serve as a useful indicator of the average time required to process a case.

49. To prevent unreasonable delay, it would be necessary that the time frame is accompanied by some mechanisms to require the CA to take appropriate action when the time frame cannot be met (see E i) below).

#### *ii) Improving communications between the CAs*

50. One of the main advantages with the MAP is that it enables CAs to resolve international tax disputes through direct and informal negotiations without having to go through traditional diplomatic channels. Direct and frequent communications between the CAs is seen as pivotal to resolving cases in a timely manner. To make the communication most effective, the important first step for each CA is to establish accessible and transparent lines of communication by designating the responsible CA staff on the case at the earliest stage then informing each other and the taxpayers involved.

51. The communication between the CAs takes the form of both written documents and more informal communication by telephone, fax or e-mail. The former is typically used when starting the negotiation process (opening letter), presenting the CA's views on the case (position paper) and reaching agreements (memorandum of understanding, closing letter). As noted in the Commentary, the formalities involved in instituting and operating the MAP should be kept at a minimum and the CAs should communicate in as flexible a manner as possible. Therefore, informal communication, such as telephone, e-mail, fax, telephone-conferencing, as well as holding face-to-face meetings are strongly encouraged. To facilitate such informal exchanges, it would be helpful if the country profile included details of the languages spoken or read by the CA staff.

52. Particularly it is recognized that face-to-face meetings often make communications between the CAs more efficient, even when there is a language barrier and interpreters may be required. It is especially useful where cases present unusual circumstances or significant issues which may not be otherwise readily resolved by other means of communication or where the CAs have a significant number of cases with a particular country. To save time and resources, CAs of several states may consider meeting up in a single location and organise a series of bilateral meetings to discuss their respective outstanding cases. While getting a group of CAs together would require a significant amount of logistical preparation, bringing together even a small number of countries in this manner could save a considerable amount of time and travel costs for the involved CAs and also facilitate the resolution of cases in a timely manner.

### *iii) Role of the position paper*

53. Current language of the Commentary does not provide any guidance as to how the MAP negotiations should be conducted. However, over the years the CAs have developed a relatively standardized procedure based on their experiences. There seems to be a consensus among countries that the negotiation process between the CAs should be started by the adjusting CA (i.e. the state initially taking the action or otherwise disturbing the taxpayer's singular taxation which led, in the taxpayer's view, to taxation potentially not in accordance with the provisions of the Convention, e.g. by raising an assessment on its taxpayer under its domestic law) issuing a "position paper", which provides the adjusting country's position on the issues in the case.

54. To facilitate consideration of the MAP case, it is critical that the position paper be provided by the adjusting CA on a timely basis and that it contains all the information necessary for the relieving (i.e. the other) CA to consider whether the action or adjustment giving rise to the MAP is justified without having to seek extensive further clarification. If a face to face meeting is scheduled, the position paper should be presented well ahead of the meeting to enable the relieving CA enough time to review the adjusting CA's position.

55. The relieving CA should undertake the evaluation of the position paper as a matter of priority (including the possibility of initial screening to make sure the position paper is complete), then provide a complete response to it within a reasonable timeframe. The possible contents of a typical position paper are illustrated in Annex 3.

### *iv) Structuring and managing the CA function*

#### *a) CA structure and organization*

56. The organisational structure and the division of functions within the CA may differ from State to State as a consequence of many factors, such as the internal organisation of the fiscal authority; the availability of qualified human resource; and the size of the MAP program (i.e., the volume of work). However, whatever organisational structure is adopted it will be important that it ensures the independence

of the CA function from the audit and assessment functions and that it enables decisions to be made in a consistent manner.

57. In some States the office of the CA operates with a degree of independence from offices within the fiscal authority that carry on treaty negotiation or deal with other international fiscal matters. In other States one office will deal with every matter of international taxation, including the CA activity. In some States, MAP cases may be initially under the responsibility of, and worked by, tax administration personnel, but final decisions or approvals are needed from legal offices. Some States retain the CA authority within an office holding legal competency but delegate to other offices the responsibility for accounting and economic analyses.

58. To avoid potential internal disagreements that may delay or inhibit the conclusion of mutual agreements, Contracting States subdividing the CA functions between different government bodies or between different offices or individuals within the same government body need to ensure that one single office or individual holds a clearly defined final decision-making power for its area of responsibility. It is critical that legislation or regulations implementing the CA function and administrative delegation orders clearly establish the CA's functional authority, e.g., which office and individuals are responsible for what, and under what circumstances, and what (if any) consents are necessary from other offices. This line of authority should be transparent to taxpayers and other CAs so that taxpayers and other CAs are not disadvantaged by not knowing the lines of authority.

#### b) Interaction with auditors

59. Some States formally or informally set up procedures under which potential MAP cases are reported to the CA and the final adjustment is implemented only when the auditor's approach is supported by the CA staff. The advantages of such procedures are that the CA views may be taken into account already at the audit stage and also that the CA has a chance to become familiarised with the case at an early stage.

60. In most cases the CA does not have any authority over the cases at the audit stage. However, the CA has the authority to review the case and overrule the auditor once a MAP has been initiated. In practice, a position paper provided from the adjusting CA is often based upon prior written analyses prepared by audit staff, but as early as possible in the MAP process, the CA must have the authoritative flexibility to adopt divergent positions to be able to effectively negotiate and conclude a mutual agreement with a treaty partner.

61. Some States have enhanced CA human resources through the use of audit staff. Although this arrangement has the advantage of utilising staff already familiar with the substantive issue, it is generally agreed that the audit officer responsible for the development of the primary adjustment should not be placed in charge of proceedings<sup>2</sup>. Such staff might have, or just as importantly, might be perceived to have a pre-determined view of a proper resolution of the case, which could adversely impact the flexibility and willingness to look at issues afresh that might be necessary to a successful negotiation of the case. Consequently, most States normally do not authorise the audit staff to conduct the actual MAP negotiations.

#### c) Resources

62. The CA needs sufficient human (skilled personnel), financial (in particular to pay for translations and travel/accommodation expenses for face-to-face meetings with other CAs) and other resources (access to company databases, industry data and foreign tax laws) to be able to meet its obligations under the

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2. See paragraph 4.54 of the Transfer Pricing Guidelines.

Convention. In particular, human resources are likely to have the most fundamental impact on the Contracting State's ability to operate an effective MAP program.

63. To ensure consistency in approach and confidentiality of information, it is recommended that the CA's decision-making authority be restricted to a few high-level officials.<sup>3</sup> The work of these high-level officials is likely to focus on implementing risk strategies, monitoring progress and making decisions at important stages of the MAP proceedings. The case-processing and case-development are assigned to CA staff having expertise and knowledge in the following areas:

- Legal analysis: knowledge in the interpretation and application of the relevant tax Convention. This would include knowledge of domestic and foreign laws, regulations, case law and of generally accepted international standards such as the Model Tax Convention and the Transfer Pricing Guidelines.
- Economic analysis: knowledge and understanding (in particular in transfer pricing cases) of the economic aspects of the transaction as well as knowledge of market, industry and commercial practices.
- Accounting and statistical data analysis: knowledge of accounting standards and practices adopted by large taxpayers. In particular cases (e.g. MAP APAs for complex transfer pricing issues) knowledge in analysing statistical data is also required.
- Expertise in examination: since the examination records are often the main information resource in the MAP case, knowledge of the examination process (documentation requirements, burden of proof etc.) and techniques (e.g. comparability searches) is also required.

64. Beyond the review of documents and information submitted by taxpayers, treaty partners and audit staff etc., the CA is also responsible for arranging meetings, keeping and filing of records and for producing position papers and reports. As the MAP involves frequent communication with taxpayers and foreign tax authorities, the CA staff should also have sufficient foreign language skills or the administration should have the financial resources to supply interpreters/translators.

65. Because of the large variety of tasks and duties falling on the CA section, few States are able to allocate CA work to a single person or a few individuals. To maximise the use of often scarce resources, some States assign cases to a team of officials which, for example, consist of a person experienced in international taxation, technical staff qualified in accounting, law or economics, and a support staff. Team work of this kind may lead to efficiency gains. The team may also, if they are regularly assigned a certain category of cases (e.g. transfer pricing cases or cases involving countries in a particular region), develop valuable experience and know-how in that particular area. This may promote consistency and help the team acquire a better understanding of foreign laws, accounting systems, markets etc. as well as foster long-term relationships between the team and CAs in other countries.

66. There are particular problems where an administration has very limited resources. MAP cases in smaller States are often assigned to the existing international division responsible primarily for treaty negotiation and international tax policy-making and co-operation. This may lead to a situation where a limited number of staff have to, on a part-time basis, deal with a large number of MAP cases or deal with highly complex MAP cases, although the assigned staff may have little experience in the issues raised by those cases.

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3. See paragraph 4.54 of the Transfer Pricing Guidelines.

67. In such situations, the CA or the responsible high-level official must monitor closely the progress of the MAP cases and the management of resources. Some countries systematically monitor progress of cases by regularly producing statistics on the cases filed and resolved over a certain period of time. This practice may not only assist senior officials in evaluating overall performance and in determining whether the resources allocated to CA work are sufficient, but may also help them identify problematic cases that have remained unresolved over a long period of time. Once identified, resources could then be re-allocated to solve such a case. There also should be an appropriate balance between the resources devoted to tax compliance and the relief of double taxation. For example, if a State dramatically increases the resources devoted to transfer pricing audits it should be recognised that the workload of the CA section is likely to increase correspondingly.

68. It is also important to “risk-assess” a MAP request at the earliest possible stage to enable the CA or the responsible high-level official to assign the MAP case in the most effective way. For example, when a case is highly complex and large amounts are at stake, or when a case involves the interpretation of a tax treaty article which may have wider implications on the State’s tax policy, it should be assigned to a high ranking senior officer or to qualified and experienced staff. On the other hand, routine cases involving limited amounts may be assigned to less experienced staff, assuming they are properly supervised. By adopting this approach, qualified and experienced staff can focus on the complex and difficult cases. At the same time, this approach reduces the risk of small cases being shelved over a long period of time.

69. Another way to improve the resource situation is to provide the CA access to specialist staff in other departments of the tax administration. The CA of some States do not have their own legal, economics and accounting units, but rely instead on other parts of the administration to provide such expertise. Yet another possibility would be to hire outside independent consultants on a temporary basis. This could be considered if a MAP case raises unprecedented issues and the CA has no experience with this type of cases. However, care must be taken that the involvement of non-CA staff does not jeopardise the independence of the MAP and harm the integrity of the CA function.

70. In some countries, administration staffs are periodically rotated to new positions. When the official in charge of a MAP case is replaced by another, this may cause delays, since the newly appointed person, even if highly qualified, will necessarily need some time to become familiarised with the case. In a worst case scenario, the consequence of a job rotation could be that the CA section loses track of the case and may have to start from the beginning and examine a huge number of documents again. One way to reduce the negative effects of job rotations is to assign MAP cases to a “team” rather than to a single individual. The remaining staff of the team may then temporarily assume the tasks of the rotated staff until the new person becomes fully capable of taking over. To enable incoming persons to become quickly familiarised with ongoing cases, all case developments, including the discussions with taxpayers and foreign CAs, should be properly recorded and all documents produced or received should be properly filed. States having adopted a periodical job rotation policy should also have in place adequate training programs for incoming staff.

71. Finally, consideration may need to be given to the way performance of CA staff is evaluated. For example, the appraisal system should provide appropriate incentives for the CA to settle cases in the principled, fair and objective manner expected under Article 25. An appraisal system that evaluates staff participating in, or otherwise affected by, CA work based on how much tax is retained in MAP negotiations is unlikely to meet the above objective.

**JWG current proposal:**

*Countries should review the current MAP processing time frame, resources and structure of their CA function in light of the above analysis and take such steps as are necessary to respond to the issues raised.*

*In particular, they are encouraged to develop and publicise a target or indicative time frame for the processing of MAP cases.*

**JWG proposal for future work:**

*The MEMAP would contain a discussion of appropriate practices in structuring the CA function, stressing the issues of resource allocation and development of timeframes.*

**D. Role of the taxpayer in the MAP**

*i) Keeping the taxpayer informed of the progress of the case*

72. Apart from initiating the MAP, Article 25 and its Commentary say relatively little about the role of the taxpayer. As a major stakeholder, taxpayers should be informed in a timely manner of important milestones in their case (e.g., acceptance of the MAP request, start of the negotiation, face-to-face meeting, and mutual agreement between the CAs). This is a recognised administrative practice in some countries, while in other countries it is a right granted to the taxpayer under the constitution or in tax laws.

73. The extent and type of information provided to the taxpayer differs among countries and also depends on the nature of the case. Some countries provide only general information on the status of the case and on the ongoing discussions between the CAs. Other countries openly discuss their position on the issues involved with the taxpayer and invite them to provide such further information as may be helpful in reaching a resolution. Country experience shows that frequent communication with taxpayers in the MAP can often be very helpful in ensuring a speedy and equitable resolution of MAP cases, especially by ensuring that both CAs have a common understanding of the facts of the case.

74. Regardless, it is important that CAs fully respect the confidentiality obligations arising under the tax convention and under relevant domestic laws. In this context, it should be noted that the CFA has approved a proposal to amend paragraph 4 of the Commentary to Article 25 as follows;

“Article 26 applies to the exchange of information for the purposes of this Article. The confidentiality of information exchanged for the purposes of a mutual agreement is thus ensured.”

75. The taxpayer has a final right to decide whether or not to accept the agreement reached between the CAs. In practice, this right also includes the right to withdraw the MAP request at any time during the proceedings, although it should be noted that this does not stop further co-operation between the CAs in the form of exchange of information. The better informed the taxpayer, the more the cooperation of the taxpayer will be enhanced which in turn will reduce the risk of resources being wasted because of the taxpayer’s withdrawal or rejection.

76. Taxpayers in MAP are often represented by advisors and consultants. However, the CAs are recommended to also maintain direct communication with the taxpayer. It is unfortunate if as a result of the lack of direct contact, the taxpayer loses an opportunity to provide the CA with timely input and/or regards MAP as a “black box” even though there are frequent communications between the CA and the taxpayer’s representative.

*ii) Participation in the presentation of the case*

77. As acknowledged in the paragraph 29 of the Commentary, taxpayers should be given every reasonable opportunity to present relevant facts and arguments to the CA. Whilst it is up to the CA to decide on the extent of the taxpayer involvement in each case, taxpayers should be permitted to make a presentation before the CA(s) when filing a MAP request. MAP cases (in particular transfer pricing cases)

are becoming increasingly complex and are often fact intensive. Therefore, the CAs may find it beneficial to invite the taxpayer to make a presentation or to answer questions of fact at a face-to-face meeting. The taxpayer may be physically present or be available on the phone during some part of the meeting.

78. Many countries have found that including the taxpayer in the way suggested above can considerably benefit the negotiation process by ensuring a common understanding of the facts of the case. Taxpayers are clearly interested parties, and indeed may have a view as to the best outcome of their case, but they are not the decision makers. MAP is a government to government process and the CAs have to bear in mind the context of MAP within the structure of the treaty as a whole, and that treaty's intention of fairly allocating taxing rights on an agreed basis. In addition, some countries fear that too heavy involvement of taxpayers in the MAP negotiations may render the task of finding a conclusion satisfactory to both the taxpayer and the CAs more difficult. Therefore, taxpayer involvement in the MAP should remain limited to presenting their views and assisting in the fact-finding, without participating in the negotiation process.

### *iii) Consultants and administrative fees*

#### a) Use of consultants

79. No country formally requires taxpayers to hire consultants to represent them in MAP and CAs should never require the taxpayer to hire outside consultants to ease CA resource problems. Simply shifting the burden from one party to another in such a way would not improve the overall operation of the MAP. Nor should the consultant effectively replace one of the CAs or the taxpayer so that the other CA feels that the MAP negotiations are really being conducted with the consultant not the CA and that the taxpayer is not involved in the process. However, experience has shown that only a small number of MAP cases are concluded without the involvement of consultants. There may be good reasons for taxpayers to hire consultants. Because for many taxpayers the MAP is a rare experience, they may conclude that it would be more effective and efficient to rely on an experienced and knowledgeable consultant who could represent them in the proceedings and provide timely professional advice and support, rather than to devote their own human resources to the case.

80. However, there may be situations where a taxpayer feels compelled to hire outside consultants because of a lack of such basic knowledge as the names and addresses of the CAs concerned or the time limit for submitting a request. Contracting States could remedy this by improving transparency of the procedures. If the MAP procedures and requirements on the taxpayers are clearly outlined in domestic guidance, taxpayers' need for consultants for this purpose could be substantially reduced.

#### b) Administrative fees

81. No OECD Member country currently charges a fee to process MAP requests. A few countries charge fees or out of pocket expenses (e.g. travel costs) to process MAP APA requests. The virtual absence of fees is primarily a consequence of the fact that taxpayers, subject to taxation not in accordance with the Convention, have a legal right under the Convention to invoke the MAP. However, where a CA suffers serious budgetary constraints (e.g. a small NOE), the question arises whether it would be acceptable for the taxpayer to pay the out of pocket expenses of the CA, e.g. to facilitate a face to face meeting. The implications of this for the integrity of the MAP process could be explored.

### *iv) Documentation requirements*

#### a) Need for adequate information without excessive burden on the taxpayer

82. When a MAP request is submitted, the CA will need some preliminary information to consider whether the case is eligible for MAP. The information necessary to process a MAP depends on the nature and complexity of the case. If the main focus of the case is on the interpretation and application of a particular article in the tax treaty, the taxpayer may not need to prepare any documentation other than some basic information about the case. On the other hand, if the case is highly factual and complex and therefore requires rigorous analysis and evaluation of facts and circumstances, the CAs involved in the process would need a considerable amount of information to examine the case properly. In either situation, it should be stressed that at the initial stage of MAP it would be enough to establish the taxpayer's eligibility for MAP, therefore it would not be necessary to review the substantive basis of the case. Accordingly, documentation the taxpayer has to provide at this stage would be considered in light of what information the CA needs to confirm the eligibility of the case for MAP.

83. Country practices show that the information requested from the taxpayer typically includes the following elements (the list below is provided only for illustrating purposes and should not be viewed as exhaustive or understood to indicate minimum compliance requirements):

Basic information on the taxpayer and the related foreign taxpayer(s): Such as the name, address, the identification number, telephone number, the name of representative, etc.

Relationship with the related foreign taxpayer(s): The control and business relationship between the applicant taxpayer and any related foreign taxpayer(s).

Functions of the taxpayer and the related foreign taxpayer(s): Description of the activities and functions of each party for transfer pricing cases.

The taxation years or periods involved

Reasons for the request: Outline of the reasons why the actions of the tax authorities have led to taxation not in accordance with the tax treaty.

Information on the relevant taxation issues: A description of the issues arising under the MAP request, including a description of the transactions between the taxpayer and the related foreign taxpayer(s), amounts and calculations of the taxation/adjustment.

Copies of documents exchanged with the tax authorities: A copy of the CA request and other documents filed, or to be filed, with the foreign CA, documents submitted in response to the action proposed or taken by the tax authority (e.g. appeal, lawsuit), the letter of assessment, other documents that substantiate the tax issues, and any correspondence with the tax authorities.

Taxpayer's views on the issues: The taxpayer's views on the issues and how the taxpayer would like to have the problem resolved under domestic law or under the applicable tax treaty.

84. Especially for transfer pricing cases, much of this information may already exist in the original audit reports and so some taxpayers have successfully speeded up the MAP process by simply handing over to both CAs copies of the entire documentation package prepared during the audit process. Moreover, the CA may have access to some of the information through the tax examiner, local tax authorities or the treaty partner. These requirements, if administered in a reasonably flexible way, should not be too difficult for the taxpayer to fulfil.

85. After both CAs have accepted a MAP request, they must form an opinion on the case based on the rules in their respective taxation laws and in the applicable tax treaty. At least in transfer pricing cases, the adjusting CA has the burden of proof of demonstrating that "the initial adjustment [...] is justified both

in principle and in amount.<sup>4</sup> Therefore, the negotiation process typically starts with the adjusting CA submitting a position paper to the relieving CA. The adjusting CA would normally not need any additional information from the taxpayer to produce the first position paper, except perhaps if the adjusting CA has concerns about the robustness of the initial adjustment. In this latter situation, the adjusting CA would likely have to examine additional information which should have been reviewed at the audit stage.

86. Additional information and documentation may be required as the discussion between the CAs proceeds. For example, in transfer pricing MAP cases where the first adjustment was made using the cost plus method based on comparable transactions found in the adjusting country, the relieving CA may argue that this method does not lead to an arm's length result and instead propose applying the resale price method based on comparable transactions in the relieving country. Although it is generally understood that the adjusting CA (i.e. the CA of country that made the initial adjustment) should provide the relieving CA with any information requested or needed to justify the initial adjustment (e.g., functional or comparability analyses), in such a case the relieving CA bears the responsibility for obtaining and providing any information needed to support its (contrary) positions. Also, assuming that the adjusting country has carried out a thorough audit and prepared a quality position paper, generally it should not be necessary for the relieving CA to re-work the audit, though there would be a need to review the reasonableness and sufficiency of the analysis undertaken by the adjusting CA.

87. The taxpayer is responsible for fully cooperating in all matters relating to the case, including supplying the information of all material changes in the information or documentation previously submitted as part of, or in connection with, the request, as well as new information or documentation relevant to the issues under consideration. Where a request also involves a related foreign taxpayer making a request to a foreign CA, the taxpayers should ensure that the same information is provided to both CAs at the same time. The timely provision of requested information is essential to enable the CAs to reach a swift and satisfactory conclusion. Thus, when requests for additional information or documentation are submitted, the taxpayer should make every effort to promptly respond to those requests. However, the CAs, when requesting information, should carefully balance the need for additional information with the concern of not over-burdening the taxpayer. In particular, when the taxpayer does not have direct access to needed information or when the taxpayer is not obliged to provide such information under domestic law, or does not need to prepare the information for accounting, regulatory or any management purposes, the CAs should make reasonable efforts to obtain such information by themselves.

88. If taxpayers have to deal with CAs in countries speaking different languages, they may also have to bear the cost of translating documents. While domestic law or guidance in many countries requires taxpayers to translate all documents into that country's language, some countries are willing to be flexible on this issue and occasionally accept abridged or partial translations or documents written in commonly used foreign languages. This practice should be, as far as it is practical, adopted by all countries.

#### b) Limitations on the introduction of documentation not provided in the audit

89. Generally taxpayers are encouraged to provide any relevant information to the CAs to help them to reach an equitable and swift conclusion. Taxpayers should be advised during the audit stage that relevant information intentionally withheld during the audit process, e.g. in response to a specific request by the auditor, may delay, or have adverse consequences for, the resolution of the MAP, if submitted later in the negotiation process. Except where new materials are requested by one of the CAs, it is at the CAs' discretion whether or not they accept any new materials introduced by the taxpayer. In exercising their discretion, the CAs will have regard to whether the information is relevant and likely to be of assistance in resolving the case. Taxpayers when they apply for the MAP should be advised that their full co-operation

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<sup>4</sup> See paragraph 6 of the Commentary to Article 9 of the Model Tax Convention.

is required during the process. Also taxpayers should be aware that the taxpayer's failure to provide relevant information in a timely manner would hinder the CA's ability to perform the MAP negotiation in an efficient and effective way, and in some situations it might be regarded as non-cooperation and lead to a denial of CA assistance.

**JWG current proposal:**

*Countries should review the structure of their current practices concerning the steps in the MAP process in the light of the above analysis and take such steps as are necessary to respond to the issues raised. In particular, keeping the taxpayer informed of the progress of the MAP case (subject to the confidentiality requirements of Article 26) should be given a high priority.*

**JWG proposal for future work:**

*The MEMAP would contain a discussion of the role of the taxpayer in the MAP process with particular attention to the necessity of developing an open and transparent process.*

**E. Improving the MAP decision-making process**

*i) Higher level review of stalled cases*

90. As discussed above, the internal management of the case is a crucial factor to improve the decision making process. Good and effective management would enable the CA to identify problematic cases at the early stage, and then to concentrate its efforts to solve them. One of the approaches proven to be effective by some States is to involve a higher ranking officer in the review process of such cases.

91. This approach would be developed bilaterally, most likely together with the adoption of a bilateral target time frame. In this setting, two countries would agree that if a case could not be solved in the agreed target time frame, senior officials would undertake a review of the case to ensure all the appropriate actions are taken to solve the case. Such an arrangement could also be viewed as one of the back up mechanisms to supplement the MAP in that it would effectively resolve the issues which could not be solved in the ordinary course of MAP or in the general time frame.

*ii) Case-by-case decisions*

92. There may be a tension when the CAs consider the approach they should take to reach an agreement. Some taxpayers prefer the CAs to adopt a pragmatic approach to resolve cases quickly, while others expect the CAs to reach a principled, legally correct answer which could possibly be used as a precedent for future years and/or other taxpayers in the same or a similar situation. As paragraph 27 of the Commentary to Article 25 notes, the CAs may have regard to considerations of equity in order to give the taxpayer satisfaction where the strict application of the domestic laws and the provisions of the Convention preclude any agreements between them. For example, in cases where the treaty provides little in the way of guidance, a principled decision will be difficult to achieve and so the CAs may have to resort to a pragmatic solution. Although it is clear in the Commentary that the former approach is exceptional and considered to be applied only to the taxpayer's benefit, there is a concern among taxpayers that cases may often be settled not on their individual merits but rather by reference to a balance of results in a number of different cases. When examining a group of cases, compromises are then made by the CAs in individual cases for the purposes of achieving an overall acceptable result. These kinds of "trade offs" are commonly referred to as "package deals" or "horse trading".

93. A similar issue arises with the "broad brush" approach under which CAs decide to settle a case based on only numbers or figures without analysing the merits of the case. This can happen in two ways.

First the relieving CA does not consider the proposed adjustment on its merits but simply tries to negotiate the adjustment down without justification (“will only accept 50% of the proposed adjustment”). Second the adjusting CA has not carried out a thorough and well founded audit but instead proposes an extremely large adjustment (say ten times more than what could be justified) on the basis that the relieving CA will give them something just to settle so that they end up in a better position than had they actually undertaken a proper audit. These approaches need to be distinguished from the situation where flexibility is needed to settle a well-founded and fully developed case in circumstances where the facts are complex and there may be more than one possible answer or a range of possible answers.

94. CAs might be tempted to resort to “trade-offs” or “broad brush” approaches when they have to resolve a large number of cases rapidly, or where they lack the specialist knowledge to examine the merits of the case or when they are under pressure to come to a conclusion on cases that have remained unresolved over a long period of time. CAs would then settle the cases simply by balancing the overall taxation rights of both countries without devoting necessary time and resources to making needed analyses, comparisons, or reviews of transactions in individual cases. The OECD Member Countries firmly disapprove of these approaches, as they do not fulfil the objectives of the MAP. Also, the adoption of such practices is counter-productive, as in the long run they will generate distrust among CAs of other countries and cause taxpayers to lose confidence in the MAP.

95. To alleviate these potential fears, it is important to make the MAP more transparent to the taxpayer, by providing taxpayers with adequate information on the on-going process and with opportunities to contribute to the process. Another way to respond to taxpayer concerns of this kind would be to disclose to the taxpayer not only the result of the negotiations, but also the approaches taken to achieve that result so that the taxpayer can be satisfied that the result was reached in a principled, fair and objective manner. This will also be essential in cases where, by the consent of the taxpayer and the CAs, the results of the MAP will be applied in future years provided the facts remain the same or similar.

**JWG current proposal:**

*Countries should review the structure of their MAP decision-making process in light of the above analysis and take such steps as are necessary to respond to the issues raised. In particular, emphasis should be placed on the fact that cases should be decided on the basis of the merits of each case and in a principled, objective and fair manner.*

**JWG proposal for future work:**

*The MEMAP would contain a discussion of appropriate practices in dealing with the MAP decision-making process, including the tension between the need to have an administrative solution to the case as quickly as possible and the desire to have consistent and principled decisions.*

*iii) “Partial” double tax relief if full settlement not possible*

96. It is regularly the situation that a MAP case poses a number of discrete and distinguishable proposed adjustments. These range from the possibility of several different transfer pricing adjustments (e.g., a pricing adjustment on a tangible goods transfer and a pricing adjustment on an intangible license), to the conjunction of a determination concerning the existence of a permanent establishment along with the amount of business profits attributable thereto, to the determination of whether and how much income is derived from employment.

97. It may be that, although what taxpayers expect from MAP is the full relief of taxation not in accordance with the article of tax treaties, in a particular case some of the issues are resolvable but others are less susceptible to a mutually acceptable conclusion. In such a situation, it is an open question whether

the conclusion of the case, considered as a whole, can be termed "successful" in eliminating double taxation. On the other hand, it may be, for example, that the taxpayer might be happier with a 90% elimination of double taxation in 12 months than 100% in 3 years, though it would depend on whether the situation is one-off or on-going. Further study may be necessary to examine if in some circumstances the "partial" relief is justified in light of the Convention, giving due consideration to: (1) since the MAP is primarily a taxpayer service, to what extent the "partial agreement" between the CAs still possibly could satisfy the taxpayer's expectations under the MAP; (2) since the MAP is a mechanism to achieve the proper allocation of taxing rights between the Contracting States, to what extent the "partial agreement" could serve to fulfil this objective; and (3) the implications of a partial solution for access to any applicable supplementary dispute mechanism.

98. Even if such a partial solution is justified in some situations, care is needed to ensure that CAs still try from the outset to fully resolve the issues in all cases. Also the giving of partial relief should not preclude, in appropriate circumstances, the giving of full relief at a later stage in the MAP process, including possibly under a SDR. It would be especially important in such a situation to make the process more transparent to the taxpayer so that the taxpayer could rely on the CAs' assertion that the partial solution is a result of the CAs' best efforts within a reasonable period of time and is the only realistic solution available in the circumstances.

#### **JWG Proposal for future study:**

*The desirability of providing a more articulated mechanism for "partial" double tax relief would be considered further and, if appropriate, changes to the Commentary to reflect these conclusions would be developed. Where partial relief is given, particular attention should be paid to the relationship to Supplementary Dispute Resolution techniques (SDRs: see Section III).*

#### **F. Effect of the MAP decision**

99. This Part of the Report considers the effect of an outcome to a MAP process which has been agreed to by the two CAs and the means through which the MAP agreement is implemented.

##### *i) Implementing the MAP decision and the relation to normal assessment procedures*

100. There is no time limit in the Article as to by when the agreed MAP must have been implemented, giving considerable discretion to tax authorities in this respect. However, such a discretion is not unlimited, and in extreme cases there would come a time where the delay was so extreme and unwarranted that there was a failure in the obligation to implement in good faith the obligations of the Convention. This is especially the case where the taxpayer has to pay the disputed tax in advance of the MAP so that the MAP can only be implemented by refunding part or all of the tax paid. It is expected that if one of the CAs is likely to have problems implementing a mutual agreement, this situation should be communicated to the taxpayer and to the other CA as soon as the problem emerges. This may mean that the MAP negotiations will not be undertaken in any case if it is apparent right from the start that one of the States would be unable to implement any future mutual agreement.

101. There is a wide range of cases between those of prompt and full implementation on the one hand, and the extreme cases just mentioned. Guidelines based on appropriate practices may be useful to focus the CAs on the need to carry through the intention of the Convention within as short a timeframe as is reasonably possible, as well as to consult the other CA where there are likely to be significant delays.

#### **JWG current proposal:**

*Countries should review their procedures for the implementation of MAP agreements in the light of the above analysis and take such steps as are necessary to respond to the issues raised. In particular, they are encouraged to develop a time frame ensuring the full implementation of the agreement, including the refund of tax paid.*

*ii )Effect of decision on subsequent years*

102. As to whether a MAP affects tax years subsequent to the tax year or years not covered by the dispute, it would not inherently do so, so that there would strictly be no obligation to even consider those years in the MAP, and a MAP agreed outcome could not be assumed to extend to those years unless it made that clear and the taxpayer is informed.

103. If, however, the MAP agreement extends *in its terms* beyond those years, then the obligation to implement would apply in respect of all of those years (although in rare cases, such as a limit in domestic law on the CA's powers, the issue of inconsistency with domestic law noted above may arise).

104. This emphasises the importance of making clear the scope of a MAP agreement, but as a matter of practice, one would assume that even if the same issue in subsequent years was not governed by the Agreement, consistency in applying the treaty would mean the same issue, at least of interpretation, should *prima facie* be treated in the same way in subsequent cases and would similarly continue to apply to more fact-based issues where the facts remained substantially the same. Also it is open to the CAs to use, with the consent of the taxpayer, the mutual agreement as a solution for open years in the same case. There are a variety of mechanisms for doing so (e.g. the Annex in the OECD Transfer Pricing Guidelines on MAP APAs describes the possibility, in appropriate circumstances, of rolling back or forward the MAP APA).

105. As a matter of practice, a State seeking to take a different approach as to future years should notify the taxpayer and possibly the other CA as soon as possible, as a new MAP may be sought on those years.

106. This approach reflects the status of the properly functioning MAP as a principled outcome rather than purely a negotiated outcome, and of the MAP as only one part of the cooperative relationship between CAs.

**JWG current proposal:**

*Countries should review their approach to the effect of a MAP agreement on subsequent years in light of the above analysis and take such steps as are necessary to respond to the issues raised.*

*iii) Effect of decision on other MAP cases*

107. There are three areas in which the authority of a CA may be affected because of the existence of issues or possible issues with other taxpayers. These would be (i) the aspect of consistency, (ii) the obligation of a State to be neutral in regard to the economic competitiveness between similarly situated taxpayers (e.g., those in the same industry), and (iii) the equitable issue of non-discrimination for taxpayers headquartered in another State. In each of these areas, the issues cluster around the question of how to ensure fairness and consistency to all taxpayers.

a) Consistency

108. Generally, both governments and taxpayers prefer that issues and cases bearing substantial similarity be resolved in a manner as close to identical as possible. One means of serving this goal is the concept of consistency. The idea here, as in any other legal setting, is that the form and principles for

resolving one set of facts be applied in the resolution of a substantially similar set of facts. In concept, most taxpayers and States agree with this idea. In particular, the CA should be consistent in terms of the applications of principles regardless as to whether they favour the CA in a particular case and regardless of whether they are the adjusting or the relieving CA. Consistency requires, for example, corresponding treatment of substantially similar inbound and outbound transactions. However, as a practical matter, in many MAP cases, at least those with regard to specific taxpayers, one or the other of the taxpayer or State could see the specific case as having a sufficient element of factual diversity so as to preclude the existence of precedent. Nonetheless, the CA may view its obligations to consistency as constraining its capacity to resolve a subsequent case in a fashion significantly different from earlier settlements. This may raise issues where the precedent is now considered not to give a desirable result or one consistent with current best practices or interpretation.

#### b) Competitiveness

109. Related to the concept of precedent is the question of competitiveness. The issue here is the need to treat similarly-situated taxpayers in a similar manner. In a sense, this is the "flip side" of the arm's length comparability methodology applied by CAs in transfer pricing cases. Taxpayers are strongly torn on this issue and do not want a CA settlement that is any worse than those of their competitors. Notwithstanding any lack of a formal or policy prohibition on a CA's authority to settle cases of competitors in a divergent fashion, most CAs would be reluctant to resolve cases differently for taxpayers in a similar situation.

#### c) Non-discrimination

110. Finally, there is the question of non-discrimination, which may be described as the competitiveness issue applied to cross-border competitors. Suppose Company X in State A has a PE(X) in State B, and the tax authority in B made an upward adjustment on PE(X) because the authority in B believes that the profit of PE(X) did not reflect the functions and risks of the PE. Suppose further that Company Y in State B has a PE(Y) in State C which performs similar functions and assumes similar risks with the PE(X), and the tax authority in C made an upward adjustment on the PE(Y). When both cases are brought to the CA of state B, could she/he possibly take a different position on these two cases in terms of the profits and expenses which should have been attributed to PE? The issue here is again to deal comparably with such competitors, and to not allow for trans-national advantages. It would be unlikely that there is a legal restriction on a CA to resolve a case to the comparative benefit of a taxpayer headquartered in its country, though there might be some restriction on adversely affecting such taxpayer. Regardless of any formal constraint, however, most CAs have the issue of non-discrimination in mind as they work through their MAP inventory. Such an approach, however, is hard to square with the more basic obligation to apply the treaty in good faith.

#### **JWG current proposal:**

*While it is clear that MAP agreements do not as such have formal precedential value, countries should review their practices concerning the treatment of other MAP agreements in the context of a particular case with a view to ensuring, to the greatest extent possible, that cases are decided on a principled basis and in a consistent manner.*

#### **JWG proposal for future study**

*Country experiences in the areas of consistency, competitiveness and non-discrimination could be further analysed to see if it would be desirable to develop more guidance in the MEMAP and/or the Commentary to Article 25*

*iv) Special Issues*

a) Secondary adjustment cases

111. Another issue arises with respect to “secondary adjustments”. Paragraph 4.70 of the OECD Transfer Pricing Guidelines addresses this issue and appears to be saying that Article 9 does not *specifically* deal with secondary adjustments, neither forbidding nor requiring them. They are not totally outside the Convention framework, so that it appears that MAP *can* apply in respect of them if the relevant conditions are met.

**JWG proposal for future study:**

*The relationship between secondary adjustments and the MAP process could be reviewed with a view toward greater emphasis on the desirability, but not the requirement, that such issues be considered in the MAP process.*

b) Triangular cases

112. One criticism made of the MAP has been that it does not adequately address situations involving third States. For example, adjusting a transaction between the parent company in State X and the second tier subsidiary in State Z may have an impact on the first tier subsidiary resident in State Y.

113. In a MAP between States X and Z, the collateral effects with State Y could not be covered as part of the MAP proceeding, although that does not mean they cannot be considered in reaching the agreement. In a formal sense, it is for State Y to protect the interests of its residents, and its involvement in a MAP needs to be supported by its own negotiated treaty rights and obligations with States X and Z.

114. This approach follows accepted international law principles that consent is generally necessary before a State can be bound by the terms of a treaty it is not a party to, that all treaties must be implemented in good faith, and that States are sovereign entities and that this sovereignty must be respected.

115. Requiring consideration of the position of third State subsidiaries in bilateral cases would not seem workable, especially in view of the possibilities of that State not being in treaty relations with the other States or a relevantly different treaty relationship. In the latter case, it may not be possible to “match up” rights and obligations across two or more treaties without breaching the terms of one.

116. There does not appear to be any reason why, in an appropriate case, the MAP could not be tripartite, particularly if the Article 26 Exchange of Information requirements in all three treaties are similar, so that there is no issue of acting contrary to any of the treaties. The issue of possible restrictions on the ability to exchange information in such cases is worth exploring. For example, even if the taxpayers give their consent to exchange information it still may not be possible under domestic law for some countries to accept such a waiver of the taxpayer’s right to confidentiality. The possibility of developing some kind of multilateral solution might be explored along the lines of the OECD/Council of Europe Multilateral Convention on Mutual Assistance in Tax Matters. Such an approach might be more convenient for taxpayers, particularly group companies, and might be an option open to taxpayers to seek where they found it more convenient. While it is clear that Article 25 does not provide a multilateral MAP, that would not appear to prevent a sort of joined bilateral procedure in certain cases, where the two MAPs are separate but conducted conjointly to the extent possible. A related issue is discussed below in Section G.

**JWG proposal for future study:**

*The possibility of a more explicit and structured approach to the issues raised in connection with “triangular” cases could be undertaken, looking to suggestions for changes in the Commentary if agreement can be obtained on an appropriate approach and the possibility of developing a multilateral solution.*

### **G. MAP cases under Article 25(3)**

117. In the previous parts of this Report, the discussion is solely focused on the taxpayer-initiated MAP (under paragraph 1 of Article 25). In addition, however, it is important to consider how the MAP under paragraph 3 of Article 25, especially the MAP for the elimination of double taxation in cases not provided for in the Convention, can best be operated.

118. Paragraph 3 of Article 25 states (emphasis added) that: “[t]he 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.” Paragraph 3, first sentence, seems to be designed for a general “housekeeping” of the Convention, rather than to deal with a particular case, but as such cases may point to more systemic issues, the paragraph does not prevent MAP being initiated on an issue arising in a particular case, or of seeking a result beneficial to a particular taxpayer. In fact, even if a taxpayer does not have a “right” to certain treatment under the Convention, CAs may agree that a matter may nevertheless proceed under paragraphs 1 and 2 or (more likely) should be considered under paragraph 3. This emphasizes the facilitative aspect of MAP, which contributes to ensuring the continuing relevance of long-lived tax treaties.

119. The second sentence of paragraph 3 is more directly aimed at particular cases but is also clearly the language of facilitation or authorization rather than of treaty *obligation*. The provision makes clear that a treaty in OECD Model form does not prevent such *consultations* on matters not covered by the Convention from occurring, indeed it is clearly intended to “invite” them (see paragraph 3 of the Commentary). It also gives great flexibility as to how the consultations occur. The second sentence also does not itself expressly afford taxpayers the same right of initiation as under paragraph 1 for matters relating to the Convention, but does not prevent CAs from together allowing such rights. In practical terms, a CA may choose to seek MAP under paragraph 3 after an issue has been drawn to its attention by a taxpayer, although such a request is not, of course, necessary for that CA to institute MAP. It supplements the MAP in Article 25, though it does not necessarily restrict what the CAs could do without this explicit provision.

120. While there has been little experience with cases arising under paragraph 3 of Article 25, the issues may well become more important in the future because of the work being done on the attribution of profits to a permanent establishment. Under the methodology adopted in the work, there is for the first time a framework that could permit the resolution of extremely complex questions concerning the allocation of profit between branches of the same taxpayer in different states, such as the attribution of capital to bank branches. Since those branches are not residents of the countries involved in the potential dispute over profit attribution, the MAP process foreseen in paragraphs 1 and 2 of Article 25 is not available and the only potential MAP relief from double taxation arises under paragraph 3. Indeed, the Commentary at paragraph 37 notes that the second sentence of paragraph 3 of Article 25 might be used to help disputes in the PE context described above. However, paragraph 37 goes on to point out some problems for some Contracting States in applying this paragraph. Also a number of States do not include the second sentence of paragraph 3 in their bilateral treaties for this and other reasons (e.g. the scope of the provision is very wide and is unclear). It would thus be appropriate to re-examine the third paragraph of the Article to make sure that it is more widely available for use in appropriate cases.

### **JWG proposal for future study:**

*The appropriate scope for paragraph 3 of Article 25 should be examined, in particular in connection with double taxation of branches of the same taxpayer, with a view to suggesting in the Commentary possible solutions to the problem.*

## **III. Supplementary Dispute Resolution Techniques**

### **A. MAP and SDR**

121. The existing MAP process provides a generally effective method of resolving international tax disputes, although as discussed in Sections I and II, a number of improvements need to be made. However, even once the improvements to the MAP discussed in this note have been made, there will still inevitably be cases in which the MAP is not able to reach a satisfactory result. These cases will typically arise when the countries involved cannot agree on the proper interpretation or application of the treaty in a particular situation. Since the MAP process as currently structured does not *require* the countries to agree, but only that they *endeavour* to agree, the result can be unrelieved double taxation or “taxation not in accordance with the Convention” in a case where the CAs are not able to reach agreement.

122. The fact that the current MAP does not require a final resolution of cases was pointed out by both private sector representatives and JWG delegates as one of the principal obstacles to ensuring an effective MAP. It causes taxpayers to hesitate in making the resource commitment to enter into the MAP and likewise provides no incentive to CAs to take all steps necessary to ensure a resolution of the issues involved.

123. The MAP process can thus be improved by supplementing it with additional dispute resolution techniques which can help to ensure that international tax disputes will to the greatest extent possible be resolved in a final, objective and principled manner for both the countries and the taxpayers concerned. Reducing the number of unresolved cross-border tax disputes in this way is clearly an important goal of the OECD work.

124. These additional techniques can make the MAP process itself more effective even in cases where resort to the techniques is not necessary. The very existence of these techniques can encourage greater use of the MAP process since both governments and taxpayers will know at the outset that the time and effort put into the MAP process will be likely to produce a satisfactory result. Further, governments will have an incentive to ensure that the MAP process is conducted efficiently in order to avoid the necessity of subsequent supplemental procedures. In addition, the introduction of supplementary dispute resolution techniques will reduce the likelihood of costly, time consuming and possibly conflicting domestic judicial proceedings. It is noted that, consistent with the mandate given to the JWG, the CFA would have to approve any work on developing recommendations for the adoption of supplementary dispute resolution mechanisms. It should be stressed that no decision has been made and current work is restricted to examining the feasibility of various proposals for supplementary dispute resolution.

### **B. Possible forms of SDR**

125. There are a number of possible SDR techniques which could be used in the tax area, including the one (review by senior officials) which is already suggested in E i) above. The current Commentary to Article 25 (paragraph 46) discusses the possibility of the CAs obtaining an “advisory opinion” from an impartial expert to help them reach a decision. In addition, the Commentary (paragraph 47) foresees the possibility of the parties obtaining an “opinion” on the “correct understanding” of a treaty provision from the Committee on Fiscal Affairs. Further, paragraph 4 of Article 25 of the Model Tax Convention and paragraphs 4 and 41 of the Commentary on that Article foresee the possible formation of a “joint

commission” to deal with some issues. Another possibility is to have a third party evaluate the strengths and weaknesses of positions taken by the parties. These techniques are forms of “mediation” in which a third party assists the parties in reaching a decision but generally does not have any independent decision-making power.

126. The most widely discussed form of SDR in the tax area is arbitration. Though a wide variety of dispute resolution techniques fall under the heading of arbitration, they have in common that a certain degree of decision-making authority is granted to neutral and independent third parties to help to arrive at a decision in the case. To this extent, the arbitration procedure has a quasi-judicial character. However, unlike a judicial process, the parties involved in effect delegate a certain amount of decision-making authority to the third party decision maker and agree, to varying degrees, to follow that decision.

127. While there are only a few examples of the actual use of arbitration to resolve cross-border tax disputes, there are a number of existing arbitration models which could be used. The EU Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises of 1990 has been extended and awaits ratification. Changes to make the Convention more effective have been undertaken in the EU Joint Transfer Pricing Forum. Over 60 existing bilateral tax conventions currently contain some sort of provision on arbitration. Thoughtful and detailed proposals for arbitration in tax matters have been made by the International Fiscal Association (See Annex 4) and the International Chamber of Commerce (See Annex 5).

128. Thus, a wide variety of SDR techniques are available which range from simply obtaining assistance in reaching a possible decision to an extensive delegation of authority to an independent body to ensure a final and consistent resolution of the issues involved. It should be noted that in all cases, however, the additional techniques are supplemental to the existing dispute resolution mechanism in the MAP. Unlike commercial arbitration, these techniques are not an alternative to the primary dispute resolution process, but complementary methods which grow out of and naturally supplement the existing MAP.

### ***C. Optional or Mandatory Submission to SDR***

129. While a number of possible SDR techniques are available, under existing practice in bilateral treaties, these techniques are all *optional* in the sense that the parties must agree in the context of the particular case to move from the “traditional” MAP procedures to submit the unresolved issue to SDR. The experience of countries having “optional” SDR procedures is that such procedures are generally ineffective. This is evidenced by the fact that despite the existence of over 60 treaties providing for “optional” arbitration, there are no reported cases under these procedures. This is to some extent understandable. Where a case has proved difficult to resolve and the parties cannot agree after a long period of consultation, it is unlikely that at that point in the progress of the case that they will be prepared to agree to move on to SDR techniques.

130. In contrast, several EU countries have reported that the procedures under EU Convention which require the submission of an unresolved case to arbitration have clearly improved the operation of the MAP procedures, as countries worked harder to achieve an adequate MAP agreement in the light of the possible required submission to arbitration.

131. There was also a clear preference expressed in the discussions with the business community for the mandatory submission of unresolved issues to an SDR process.

132. In the light of this experience, it is clear that the MAP process would be improved if there was a mandatory requirement that, under certain circumstances, an unresolved case must be submitted to SDR procedures. This obligation could possibly be viewed as arising from the general international law

obligation to apply and interpret the treaty in good faith and gives more content to the requirement in the Model Convention to “endeavour.... to resolve the case.” It should be stressed that this proposal deals only with the mandatory *submission* of the unresolved case to SDR. Section D discusses the issue whether there should be an optional or mandatory *resolution* of the case.

133. One question is whether this mandatory submission approach could be developed in the context of existing treaties by providing more explicit guidance in the Model Commentary regarding the use of SDR or would require some other mechanism for implementation, such as a change to the Articles of the Model Tax Convention. In particular, different SDR techniques could be appropriate for different situations. Thus, some sort of advisory opinion might be appropriate if the issue preventing resolution of the case was a narrow question of treaty interpretation. On the other hand, a more full-blown arbitration procedure might be required to resolve certain aspects of a complex transfer pricing situation.

#### **JWG proposal for future work:**

*The JWG will develop a proposal examining the feasibility of implementing the mandatory submission (not mandatory resolution) of unresolved MAP cases to a form of supplementary dispute resolution mechanism in the light of the general international law obligation to apply and interpret the treaty in good faith. This could possibly involve amending paragraphs 26 and 46-48 of the Commentary to Article 25 to make explicit that the international law obligation of endeavouring in good faith to come to an agreement when applying the MAP process requires that, where agreement has not been possible under the normal MAP discussions, the unresolved issue(s) will be submitted to the appropriate form of supplement dispute resolution procedure. Other implementation techniques might also be feasible, including changes or additions to the Articles of the Model Tax Convention.*

*To help implement the proposal for mandatory submission of unresolved issues to SDR, the JWG would outline the procedures which could be used for such submission including:*

- *An evaluation of the various forms of SDR and the situations for which they would be suitable*
- *The time frame or “triggering” device which would result in the required submission of the unresolved issue to SDR*
- *The role of the taxpayer in the SDR process, including the agreement to the submission and the circumstances in which the taxpayer could be denied access to SDR*
- *The direct participation of the taxpayer in the SDR process*
- *The relation between the SDR process and the taxpayer’s domestic law remedies*
- *The relation between the SDR decision and the MAP process generally*
- *The form and publication of the SDR decision*
- *The operational and procedural details for carrying out the SDR process*

*The procedures could be implemented by changes in the Commentary to Article 25 and/or the development of appropriate practices in the MEMAP.*

#### ***D. Optional or Mandatory SDR Resolution***

134. It should be stressed again that the proposal above deals only with the mandatory submission of the unresolved case to SDR. After the input from the SDR procedure into the MAP, it would still be necessary that both the CAs and the taxpayer agreed to follow the guidance provided in the SDR. It would thus still be possible even after the SDR process that the case would be unresolved.

135. It is not possible under the existing Model Convention or bilateral treaties based on the Model to ensure that all MAP cases are resolved since the obligation provided in those instruments is only to “endeavour” to agree (see paragraph 26 of the Commentary to Article 25, i.e. no mandatory resolution). Given the importance of providing to the largest extent possible that all international tax disputes are satisfactorily resolved, however, it would be desirable to develop an alternative procedure which would ensure the mandatory resolution of unresolved issues for countries that wished to provide for the binding resolution of all cases.

136. It is recognized that for some countries there are legal and constitutional impediments to some forms of binding dispute resolution. Nonetheless, the proposal would provide guidance for those countries who wished to develop a binding procedure for the handling of tax disputes in their bilateral relationships, for example by developing in the Commentary to Article 25 a possible new Article and attendant Commentary which could be used by those countries that wished to develop a binding procedure.

#### **JWG proposal for future work:**

*The JWG will develop a proposal examining the feasibility of implementing the mandatory resolution of unresolved MAP for use only by countries that wished to provide for binding resolution of all cases. This would likely involve the development of the text of a new Model Convention Article and attendant Commentary or might take some other form.*

*The work foreseen in the “resolution” proposal would involve guidance on the following issues:*

- *The relation between the SDR decision and ongoing MAP process including the question of whether or not the SDR should be binding on governments and the taxpayer*
- *Issues involved in implementing the SDR decision*
- *The necessary modifications of the issues dealt with in the “submission” proposal to take into account that the resolution of the issue would in some fashion be binding*

#### ***E. Possible Further Action***

137. In recognition of the importance of making progress in the development of SDR procedures, it would be possible, if the CFA agrees, for the OECD Council to adopt a Recommendation urging the inclusion of some form of SDR procedures in bilateral treaties where possible.

## ANNEX 1: THE JWG PROPOSALS

### **JWG Current Proposals:**

1. Countries would review the guidance currently published on domestic rules and procedures for MAP to ensure that it meets the criteria for transparency set out in this note. Such guidance would include the country position on both operational and technical issues. Countries that have not yet published any such guidance are strongly recommended to do so as soon as practicable.
2. The work on publication of Country Profiles is to be continued, country coverage to be expanded and the profiles are to be kept up to date and expanded to reflect future developments in the ongoing work. In particular, NOEs would be encouraged to participate in the process.
3. Countries would review the legal authority of the CA and clarify in their Country Profiles the extent of the CA authority and any specific limitations on the issues that can be subject to the MAP.
4. Countries should review the current MAP processing time frame, resources and structure of their CA function in light of the above analysis and take such steps as are necessary to respond to the issues raised. In particular, they are encouraged to develop and publicise a target or indicative time frame for the processing of MAP cases.
5. Countries should review the structure of their current practices concerning the steps in the MAP process in the light of the above analysis and take such steps as are necessary to respond to the issues raised. In particular, keeping the taxpayer informed of the progress of the MAP case (subject to the confidentiality requirements of Article 26) should be given a high priority.
6. Countries should review the structure of their MAP decision-making process in light of the above analysis and take such steps as are necessary to respond to the issues raised. In particular, emphasis should be placed on the fact that cases should be decided on the basis of the merits of each case and in a principled, objective and fair manner.
7. Countries should review their procedures for the implementation of MAP agreements in the light of the above analysis and take such steps as are necessary to respond to the issues raised. In particular, they are encouraged to develop a time frame ensuring the full implementation of the agreement, including the refund of tax paid.
8. Countries should review their approach to the effect of a MAP agreement on subsequent years in light of the above analysis and take such steps as are necessary to respond to the issues raised.
9. While it is clear that MAP agreements do not as such have formal precedential value, countries should review their practices concerning the treatment of other MAP agreements in the context of a particular case with a view to ensuring, to the greatest extent possible, that cases are decided on a principled basis and in a consistent manner.

### **JWG Proposals for Future Work:**

1. A Manual on Effective Mutual Agreement Procedure practices (“MEMAP”) would be developed for both tax administrations and taxpayers. The positions taken in the Manual would not be binding on Member countries but would reflect the analysis done in connection with the particular issue. The MEMAP would discuss appropriate practices and possible alternative approaches to issues considered by the JWG.

The individual issues which would be covered in such a Manual are discussed in detail in the relevant parts of this Report.

2. Work would be undertaken to analyse time limitation requirements and discuss possible solutions in this regard, taking into account the differences in domestic rules. This work could result in the development of guidance on appropriate practices in the MEMAP with a view towards improving transparency on this issue and giving taxpayers an opportunity to protect their position. It could possibly also result in changes to the Commentary on Article 25.
3. Changes in the Commentary would be developed dealing with the “probability” of taxation not in accordance with the Convention and giving guidance as to how to apply this requirement, including what can be done to ensure that the taxpayer is aware that the time period has begun to run.

The MEMAP would also include a discussion of the issue of “probability” of taxation not in accordance with the Convention.

4. The circumstances in which a taxpayer should be denied access to the MAP would be analysed together with a discussion of possible appropriate practices in this regard, taking into account the differing domestic law circumstances in different countries. This analysis would be reflected in the MEMAP, and, if it were thought necessary, in the Commentary to Article 25.
5. The circumstances where domestic law procedural requirements or administrative practices effectively block taxpayer access to MAP would be analysed together with a discussion of appropriate practices in this regard, taking into account the differing domestic law circumstances in different countries. This analysis would be reflected in the MEMAP.
6. An analysis of country practices concerning the suspension of collection of tax during the MAP process would be made and an attempt to reach a consensus position that alternative methods of ensuring collection and otherwise protecting government interests could be developed. The outcome of this work could be included in the MEMAP and, to the extent deemed appropriate, in the Commentary.
7. An analysis of country practices concerning the suspension or remission of interest and penalties during the MAP process would be made and an attempt to reach a consensus position as to whether and when the suspension of interest obligations and penalty payments is appropriate could be developed. The outcome of this work could be included in the MEMAP and, to the extent deemed appropriate, in the Commentary.
8. An analysis of legal authority necessary to conclude and implement MAP agreements would be made and that analysis would be reflected in the MEMAP with the recommendation that all countries grant the CAs the necessary authority for the MAP process to operate effectively.

9. The Commentary to Article 25 would be clarified to indicate the circumstances in which the MAP can be applicable in situations involving corresponding adjustments.
10. Subsequent revisions to the Commentary to substantive treaty articles may point out that in some circumstances application of the appropriate interpretation may be able to avoid the necessity of recourse to MAP, whilst leaving open the possibility of still using MAP where this is not possible.
11. Country issues concerning the relationship between domestic law and the MAP process would be analysed and addressed with a view to allowing the MAP to operate to the fullest extent possible, taking into account the possible constitutional and other legal limitations in the domestic legal systems. The outcomes of this work could be reflected in the MEMAP and/or in changes to the Articles of the Model Tax Convention or to the Commentary.
12. The MEMAP would contain a discussion of appropriate practices in structuring the CA function, stressing the issues of resource allocation and development of timeframes.
13. The MEMAP would contain a discussion of the role of the taxpayer in the MAP process with particular attention to the necessity of developing an open and transparent process.
14. The MEMAP would contain a discussion of appropriate practices in dealing with the MAP decision-making process, including the tension between the need to have an administrative solution to the case as quickly as possible and the desire to have consistent and principled decisions.
15. The JWG will develop a proposal examining the feasibility of implementing the mandatory submission (not mandatory resolution) of unresolved MAP cases to a form of supplementary dispute resolution mechanism in the light of the general international law obligation to apply and interpret the treaty in good faith. This could possibly involve amending paragraphs 26 and 46-48 of the Commentary to Article 25 to make explicit that the international law obligation of endeavouring in good faith to come to an agreement when applying the MAP process requires that, where agreement has not been possible under the normal MAP discussions, the unresolved issue(s) will be submitted to the appropriate form of supplement dispute resolution procedure. Other implementation techniques might also be feasible, including changes or additions to the articles of the Model Tax Convention.

To help implement the proposal for mandatory submission of unresolved issues to SDR, the JWG would outline the procedures which could be used for such submission including:

- An evaluation of the various forms of SDR and the situations for which they would be suitable
- The time frame or “triggering” device which would result in the required submission of the unresolved issue to SDR
- The role of the taxpayer in the SDR process, including the agreement to the submission and the circumstances in which the taxpayer could be denied access to SDR
- The direct participation of the taxpayer in the SDR process
- The relation between the SDR process and the taxpayer’s domestic law remedies

- The relation between the SDR decision and the MAP process generally
- The form and publication of the SDR decision
- The operational and procedural details for carrying out the SDR process

The procedures could be implemented by changes in the Commentary to Article 25 and/or the development of appropriate practices in the MEMAP.

16. The JWG will develop a proposal examining the feasibility of implementing the mandatory resolution of unresolved MAP for use only by countries that wished to provide for binding resolution of all cases. This would likely involve the development of the text of a new Model Convention Article and attendant Commentary or might take some other form.

The work foreseen in the “resolution” proposal would involve guidance on the following issues:

- The relation between the SDR decision and ongoing MAP process including the question of whether or not the SDR should be binding on governments and the taxpayer
- Issues involved in implementing the SDR decision
- The necessary modifications of the issues dealt with in the “submission” proposal to take into account that the resolution of the issue would in some fashion be binding

#### **JWG Proposals for Future Study:**

1. The possibility of developing some kind of analysis of the ongoing status of MAP cases in Member countries would be explored, including the type of information that would be disclosed.
2. The desirability of providing a more articulated mechanism for “partial” double tax relief would be considered further and, if appropriate, changes to the Commentary to reflect these conclusions would be developed. Where partial relief is given, particular attention should be paid to the relationship to Supplementary Dispute Resolution techniques.
3. Country experiences in the areas of consistency, competitiveness and non-discrimination could be further analysed to see if it would be desirable to develop more guidance in the MEMAP and/or the Commentary to Article 25.
4. The relationship between secondary adjustments and the MAP process could be reviewed with a view toward greater emphasis on the desirability, but not the requirement, that such issues be considered in the MAP process.
5. The possibility of a more explicit and structured approach to the issues raised in connection with “triangular” cases could be undertaken, looking to suggestions for changes in the Commentary if agreement can be obtained on an appropriate approach and the possibility of developing a multilateral solution.
6. The appropriate scope for paragraph 3 of Article 25 should be examined, in particular in connection with double taxation of branches of the same taxpayer, with a view to suggesting in the Commentary possible solutions to the problem.

## ANNEX 2: ILLUSTRATIVE TIME FRAMES OF KEY MAP PROCEDURAL STEPS

The table below outlines the key procedural steps and gives illustrative time frames. Article 25 of the OECD Model Tax Convention sets forth procedures for resolving three different categories of problems that may arise under the Convention. While the MAP is not restricted to the one which involves and affects specific taxpayers, the large majority of MAPs are initiated by taxpayers and this timetable is applicable only to those. This table illustrates the time frame where the MAP is triggered by the action of a tax authority on a resident taxpayer, then according to paragraph 1 of Article 25, the taxpayer has presented its case to the “the adjusting CA”(see paragraph 53 above).<sup>5</sup> This table demonstrates the process from the time it is initiated with the presentation of the case to the CA in the taxpayer’s state of residence, to the end with the implementation of the mutual agreement by the CAs involved. During the initial stage, the MAP is mainly the interactions between the taxpayer and the CA of the State of which the taxpayer is a resident. If the taxpayer’s complaint appears to be justified and the adjusting CA is not able to arrive at a satisfactory solution at the domestic level, the CA proposes to start MAP negotiation to the other CA. The second stage opens with the issuance of the position paper from the adjusting CA to the relieving CA. Both CAs will then review the case and try to reach agreement through negotiation. In the last stage, assuming successful conclusion of the MAP, the Contracting States will take appropriate measures to implement the mutual agreement.

It is worth stressing that the efficiency of the MAP process is greatly dependent on the efficiency of the audit process that lead to the dispute. The following timetable assumes that the Contracting State has made an initial adjustment based on a thorough and well documented analysis consistent with domestic laws and internationally accepted standards (e.g. the OECD Transfer Pricing Guidelines). By contrast, where a Contracting State has not carried out a proper functional or comparability analysis, or where the analysis lacks adequate supporting documentation, the MAP is likely to be problematic and prolonged as there will be a need for the CA to effectively carry out the audit again.

Also, it should be noted that the relative emphasis on, and length of each of, the stages will necessarily vary according to the nature of the case and the type of MAP. Also, the MAP with countries which use different language may take longer than indicated in the following section, because of the necessity of translation. Finally, it is not intended to discourage the CAs to mutually agree to conduct MAP in more informal and effective ways.

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<sup>5</sup> Depending on the case, the initial MAP request can be submitted to the other State. But the timeframes and necessary actions in each stage would be unchanged.

<b>Stage</b>	<b>Action</b>	<b>Illustrative Target Time Frame</b>
<b>First stage</b>	Initiation of MAP by taxpayer: submission of MAP request	Time-limit provided for by the treaty (OECD Model Convention: 3 years) or domestic provisions and practices either in the absence of an express treaty provision or if more favorable than the treaty provision.
	Confirmation of the receipt of MAP request to the taxpayer. Forwarding the MAP request by taxpayer to the other CA. The taxpayer or associated enterprise in the other country is also encouraged to contact the CA in the other country and to provide all supporting materials to both CAs promptly and simultaneously.	Immediately after the submission of the case
	Review of case by adjusting CA Possible requests for additional information to taxpayer	Within a month after initiation by taxpayer of MAP.
	Determination of eligibility for MAP by adjusting CA Notification to taxpayer by adjusting CA if the case is accepted or rejected (If accepted) Proposal to relieving CA to start MAP negotiation : issuance of opening letter	Within a month after the necessary information is provided to the adjusting CA
	Confirmation by relieving CA of receipt of MAP request, preliminary screening for completeness of request and notification of decision to accept or reject request.	Within a month after the receipt of the opening letter.
<b>Second stage</b>	Initiation of MAP consultations with other State: Issuance of position paper by adjusting CA	Ideally within 4 months, but no later than 6 months after agreement between CAs to enter into MAP consultations
	Review of case by relieving CA, preliminary screening for completeness of position paper and notification of missing information and determination whether it can provide unilateral relief to taxpayer. Response to the position paper by relieving CA.	Within 6 months of receiving the position paper.
	Negotiation between the CAs <sup>6</sup>	
<b>Third Stage</b>	Mutual Agreement between the CAs: document the CA agreement in the form of memorandum of understanding	Within 24 months on average after initiation by taxpayer of MAP.
	Taxpayer's (and other interested parties' <sup>7</sup> ) approval of mutual agreement.	To be submitted immediately after conclusion of mutual agreement. 1 month deadline to respond.
	Confirmation of mutual agreement with terms and conditions: exchange of closing letters	As soon as possible after acceptance of mutual agreement by taxpayer (and possibly other parties).
	Implementation of mutual agreement.	No later than 3 months after exchange of closing letters.

<sup>6</sup> Face to face meeting(s) between the CAs can be organized in this stage, or in any other stages when necessary.

<sup>7</sup> Where the administrative-territorial subdivision's or any local tax authorities' consents are necessary or required.

### ANNEX 3: CONTENTS OF POSITION PAPER

The position paper is provided by the adjusting CA, i.e., the state having taken an action which led to the taxation not in accordance with the provision of Convention. To facilitate consideration of the MAP case, it should be provided on a timely basis and contain all the necessary information for the relieving Contracting State as follows:

- a) Formal name and address and taxpayer identification number of the person subject to the taxation, its related persons in the other country and the basis for determining the association;
- b) Outline of the business of the taxpayer subject to adjustment;
- c) Taxable years subject to adjustment;
- d) Amount of income and tax adjusted for each taxable year;
- e) Summary of the relevant information from the original tax return;
- f) Transactions, businesses and products subject to the adjustment;
- g) Description of the exact nature of the adjustment and the relevant authority under both domestic law and treaty articles for the adjustment;
- h) The approach used in calculating the adjustment amount together with supporting data. Such items may include, where relevant and appropriate, economic data and reports relied upon and explanatory narratives as well as taxpayer documents and records;
- i) The contact details of the officials in charge of the case.

In transfer pricing cases, the following additional information should be provided:

- j) Outline of comparable transactions and methods for adjusting differences;
- k) Description of the methodology employed for the adjustment;
- l) An explanation of the appropriateness of the transfer pricing methodology employed for the adjustment, i.e. the adjusting CA should explain why it believes the adjustment achieves an arm's length outcome.

In response to the position paper, the relieving CA will review the case and then provides the adjusting CA with its views. To enable the adjusting CA to identify the areas of disagreement and to understand the overall position of the relieving CA, the response to the position paper should include the following:

- a) Indication of whether the relief proposed by the adjusting country can be accepted;
- b) Indication of the areas where the relieving CA accepts the adjusting CA's position;
- c) Indication of the areas where the relieving CA disagrees with the adjusting CA's position;

- d) Request for additional information and explanations necessary to clarify the issues at stake;
- e) Presentation of other issues and information considered pertinent to the case, but not raised in the adjusting CA's position paper; and
- f) Submission of proposals or views as to c) above.

If the CAs involved intend to hold a face-to face meeting, some of the issues listed above may then be addressed at the meeting. In such a case, the response to the position paper from the relieving CA is likely to focus primarily on f) above.

## ANNEX 4: IFA ARBITRATION PROPOSAL

### Arbitration of Disputes Arising Under Income Tax Treaties: Model Treaty Article and Memorandum of Understanding\*

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III.	MEMORANDUM OF UNDERSTANDING .....	45

#### I. Introduction

Attached is the text of an Appendix which forms part of an independent study prepared by William W. Park and David R. Tillinghast under the auspices of the International Fiscal Association. Entitled *Tax Treaty Arbitration*, the study will be published in book form.

The proposed provisions for tax treaty arbitration divide themselves into two groups: first, provisions to be included in the body of the treaty itself, as an extension of the Mutual Agreement Procedure now included as Article 25 of the OECD Model Convention; and second, a Memorandum of Understanding setting forth many of the details for implementing the arbitral procedure. There is no magic in such a division, and any selection of items for one document or the other will to some extent be arbitrary. The aim of the classification has been to promote a reasonable flexibility in carrying out the objectives of the arbitration provisions. To this end the treaty might well grant the competent authorities limited power to modify the Memorandum of Understanding as their experience suggests more appropriate mechanisms, at least in those cases in which this delegation of authority would not raise constitutional or other legal issues under national law.

The proposed provisions are presented as they would appear in a bilateral convention. If a multilateral convention were to be adopted, some of the language would have to be re-drafted although the substance would remain the same.

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The draft set forth below and the draft proposed by the ICC Commission on Taxation<sup>8</sup> are similar in many respects, but also diverge in significant ways. The following structural items are included in this study's proposal but not the ICC draft: (i) reference to an appointing authority; (ii) a control mechanism to address aberrant awards; (iii) coordination with the United Nations Arbitration Convention; and (iv) a *lis alibi pendens* provision that suspends litigation until conclusion of the arbitral proceedings.<sup>9</sup> In addition, the proposal below includes procedural mechanisms not found in the ICC Model, such as provision for (a) Terms of Reference; (b) jurisdictional limits; (c) language of proceedings; (d) arbitral situs; (e) interim measures; (f) penalties; (g) arbitrator qualification; (h) declaratory relief and (i) "last best offer" (baseball) arbitration.

In a few instances, alternative language is presented below. In such cases, reference is made to the portions of the text in which these alternatives are discussed.

## II. Double Taxation Convention Article on Arbitration

### Article 25A: Arbitration of Treaty Controversies

#### 1. Binding Arbitration

(a) If a case has been presented to the competent authority of one of the Contracting States in accordance with paragraph (1) of Article 25 and within two years following such presentation the competent authorities have not reached a mutual agreement [or if the person presenting the case to the competent authority (the "taxpayer") considers that the agreement reached is not in accordance with this Convention], the matter shall be settled by binding arbitration in accordance with this Article and with a Memorandum of Understanding to be exchanged through diplomatic channels, which the competent authorities may from time to time modify and supplement in order better to implement the provisions of this Article.

(b) The seat of the arbitration shall be selected by the Arbitral Tribunal but in all cases shall be in one of the Contracting States. The award shall be deemed made in such Contracting State, although for convenience arbitrators may hold hearings or deliberations in any location.<sup>10</sup>

#### 2. Taxpayer Agreement to Arbitrate

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<sup>8</sup> Arbitration in International Tax Matters, Draft Bilateral Convention Article, Doc. No. 180/455 Rev. (10 September 2001). See Generally, Robert Couzin, *Arbitration in Tax Treaties*, 29 TAX PLANNING INTERNATIONAL REVIEW 12 (March 2002);

<sup>9</sup> The ICC language in paragraph 2(b) provides for the commencement period of the arbitration to be deferred "if the case has also been submitted to a competent court."

<sup>10</sup> Parties to commercial and investment arbitrations would normally situate the proceedings within the territory of a third country to reduce the prospect that courts of home party's home country would be tempted to vacate an award for partisan reasons. In the arbitration scheme proposed by this draft treaty article, however, each country irrevocably waives the right to apply its own arbitration law's grounds for award vacatur. See Draft Article 7(f).

#### Alternative 1

Arbitration will take place only if the taxpayer and all relevant associated enterprises in each Contracting State, if any, submit in writing to both of the competent authorities their agreement that the case will be subject to arbitration as provided herein and that the taxpayer and each such enterprise will be bound by any final award.

#### Alternative 2

A taxpayer presenting a request to the relevant competent authority must, as a condition to its consideration, submit in writing to such authority its agreement, and the agreement of all relevant associated enterprises in each Contracting State, if any, that the case will be subject to arbitration as provided herein and that the taxpayer and each such enterprise will be bound by any final award.

#### Alternative 3

A taxpayer submitting a case to the relevant competent authority must, as a condition of its consideration of the request, submit in writing to such authority its agreement, and the agreement of all relevant associated enterprises in each Contracting State, if any, that it will not bring or prosecute any judicial or administrative proceeding under the national law of either Contracting State relating to the subject matter of the case. Arbitration will take place only if thereafter the taxpayer and each such enterprise submits in writing to both of the competent authorities its agreement that the case will be subject to arbitration as provided herein and that the taxpayer and each such enterprise will be bound by any final award.

### 3. Initiation of Arbitration

Arbitration may be initiated by the competent authority of either Contracting State or the taxpayer by submitting a written Request for Arbitration to the Appointing Authority designated in paragraph 5 of this Article no sooner than two (2) years and not later than four (4) years following the initial presentation of the case to the relevant competent authority.

### 4. Matters Subject to Arbitration

All issues arising under this Convention may be subject to arbitration except those relating to Articles 25-30 [of the current OECD Model Convention, concerning the mutual agreement procedure, exchange of information, diplomatic and consular missions, territorial extension, entry into force and termination]. In any case in which an arbitral tribunal decides that the Convention rather than national law governs a particular issue or claim, the decision not to apply national law shall be subject to judicial review pursuant to Articles 7(b)(ii) and 8(b).

### 5. Constitution of the Arbitral Tribunal

(a) The Permanent Court of Arbitration in the Hague shall serve as Appointing Authority and fulfill all functions assigned to it under this Article and the related Memorandum of Understanding.

(b) Number of Arbitrators and Method of Appointment

#### Alternative 1

Unless the competent authorities of both Contracting States and the taxpayer agree otherwise, the Arbitral Tribunal shall be composed of three members.<sup>11</sup> Within sixty days after a Request for Arbitration has been filed, the competent authority of each Contracting State shall nominate one arbitrator. Unless the two arbitrators so nominated can agree on a Presiding Arbitrator within thirty days after the nomination of the later of the two, the Presiding Arbitrator shall be nominated by the Appointing Authority. Should any Contracting State fail to appoint an arbitrator within the above-mentioned time, such nomination shall be made by the Appointing Authority.

#### Alternative 2

Unless the competent authorities of both Contracting States and the taxpayer agree otherwise, the Arbitral Tribunal shall be composed of four members. Within sixty days after a Request for Arbitration has been filed, the competent authorities of the Contracting States and the taxpayer shall each nominate one arbitrator. Unless the three arbitrators so nominated can agree on a Presiding Arbitrator within thirty days after the nomination of the last of the three, the Presiding Arbitrator shall be nominated by the Appointing Authority. Should any Contracting State or the taxpayer fail to appoint an arbitrator within the above-mentioned time, such nomination shall be made by the Appointing Authority.

#### Alternative 3

Unless the competent authorities of both Contracting States and the taxpayer agree otherwise, the Arbitral Tribunal shall be composed of five members. Within sixty days after a Request for Arbitration has been filed, the competent authorities of the Contracting States and the taxpayer shall each nominate one arbitrator. Unless within thirty days after the nomination of the last of the three, the three arbitrators so nominated can agree on two other arbitrators and the designation of one to serve as Presiding Arbitrator, then the other two arbitrators shall be nominated and the designation of the Presiding Arbitrator shall be made by the Appointing Authority. Should any Contracting State or the taxpayer fail to appoint an arbitrator within the above-mentioned time, such nomination shall be made by the Appointing Authority.

#### Alternative 4

Unless the competent authorities of both Contracting States and the taxpayer agree otherwise, the Arbitral Tribunal shall be composed of three members all of whom shall be named by the Appointing Authority.

(c) No arbitrator may be an employee or consultant of a Contracting State or the taxpayer or any related person. Each individual nominated to serve as an arbitrator shall disclose links to either Contracting State or the taxpayer or any related person that might create reasonable doubts about the individual's ability to render a fair decision.

(d) The Presiding Arbitrator shall be a lawyer fluent in [language(s) appropriate for both parties], shall not have the nationality of either Contracting State and shall be independent of the governments of both Contracting States and the taxpayer(s). The Presiding Arbitrator shall have substantial experience in international arbitration, in addition to familiarity with international tax matters.

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<sup>11</sup> Normally in commercial and investment arbitration the parties would avoid an even numbered tribunal, to reduce the prospect of tie and deadlock. To meet this possibility, the Memorandum of Understanding (Section 8) gives the Presiding Arbitrator the power to decide cases in the absence of a majority.

(e) Either competent authority or the taxpayer may challenge an arbitrator's qualifications or independence by submitting a written statement to the Appointing Authority specifying the facts on which the challenge is based. Such challenge shall be made within thirty (30) days from receipt from the Appointing Authority of notification of the appointment or from the date on which the challenging party became aware of the circumstances on which the challenge is based. The Appointing Authority shall determine whether the individual shall serve or continue to serve.

## 6. Lis Alibi Pendens

Arbitral proceedings pursuant to this Article shall suspend any pending judicial or administrative proceedings in either of the Contracting States involving the arbitration's parties and subject matter.<sup>12</sup>

## 7. Enforcement of Arbitration and Arbitral Awards

(a) As provided in this Article or the Memorandum of Understanding giving effect thereto, each Contracting State shall grant recognition to and enforce the commitment to arbitrate herein and any resulting award.

(b) Each Contracting State irrevocably waives any right to assert that controversies subject to this Article are non-arbitrable and shall grant to an award rendered pursuant to this Article the same *res judicata* effect as a final domestic judgment. Awards rendered pursuant to this Article shall be subject to challenge only for (i) an arbitrator's bias or corruption, (ii) an award misconstruing the arbitral tribunal's jurisdiction (iii) irregular composition of the arbitral tribunal or (iv) conduct of the proceedings in a way that denies a participant the opportunity to present its case or which deviates significantly from the procedural mission established by the Contracting States.<sup>13</sup>

(c) To the extent relevant, each Contracting State accepts that any award shall be considered "not domestic" under the 1958 United Nations Arbitration Convention, that a claim submitted to arbitration shall be considered to arise out of a commercial relationship or transaction, and that the Contracting States shall be considered "persons" for purposes of applying that Convention.

(d) Public policy shall not be deemed to have been violated solely by reason of the arbitrators' substantive decision on the legal and factual merits of the case.

(e) No award under this Article shall be denied recognition by reason of the Act of State doctrine.

(f) The otherwise applicable grounds for vacating an arbitral award under national arbitration law shall not apply. Review of arbitral awards shall be limited to the country in which the award is presented for recognition.

## 8. Jurisdictional Rulings

(a) Subject to the last sentence of paragraph 4 and paragraph 7(b)(ii), the arbitral tribunal may rule on whether matters submitted to arbitration fall within the tribunal's jurisdiction.

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<sup>12</sup> This provision may have to be modified in some instances to take into account restrictions imposed by national law, to the extent that these cannot be modified by adoption of this treaty provision.

<sup>13</sup> These grounds for non-recognition mirror the essence of the bases for non-recognition set forth in Article V(1)(a)-(d) of the New York (United Nations) Convention.

(b) Any such ruling may be challenged at the time the award is presented for recognition and enforcement.

(c) In the event that an arbitral tribunal fails to decide a claim because it deems the matter to be outside the scope of the convention, and thus governed solely by national law, either Contracting State or the taxpayer may challenge this finding before a Jurisdictional Review Panel. This Panel shall be constituted according to the process provided in Article 5. The Panel shall consider de novo whether the claim is governed by the Convention. The decision of the Panel shall be final. Following a decision that a claim is governed by this Convention, a new arbitral tribunal shall be constituted pursuant to Article 5 and shall be bound by the Panel's jurisdictional determination.

### **III. Memorandum of Understanding**

#### **1. Procedural Rules for Establishment of Facts and Law**

(a) The Arbitral Tribunal shall establish the facts and law of any case by all means that it deems appropriate.

(b) Each Contracting State and the taxpayer shall have an equal right to make submissions and, at the discretion of the Arbitral Tribunal, to present oral testimony.

(c) The Arbitral Tribunal shall look for guidance to the Arbitration Rules of the International Chamber of Commerce and to the IBA Rules on the Taking of Evidence in International Commercial Arbitration.<sup>14</sup>

(d) At the outset of the proceedings, the competent authorities shall furnish to the Arbitral Tribunal all written communications between them which describe the relevant issues. Based on these submissions, the Arbitral Tribunal shall, in consultation with them and the taxpayer, establish Terms of Reference setting forth the scope of the arbitration and relevant issues.

(e) In all cases, each of the competent authorities and the taxpayer will be entitled to submit at least one memorandum and one rebuttal memorandum (each relating to relevant issues of law and fact), along with witness statements and expert reports where appropriate.

#### **2. Language**

The language of the arbitration shall be [\_\_\_\_\_] unless otherwise agreed by the competent authorities.

#### **3. Applicable Law**

The Arbitral Tribunal shall apply the terms of the Convention. In determining the intent of the Contracting States, the Arbitral Tribunal shall apply the principles of the 1969 Vienna Convention on the Law of Treaties, including reference to the following interpretative aids:

(i) jointly agreed commentaries and explanations of the Contracting States;

(ii) common principles of the Contracting States' laws;

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<sup>14</sup> The 1999 IBA Rules on Evidence provide the most current thinking on evidentiary standards appropriate for cross-border disputes. The ICC Rules were suggested because they have been the subject of extensive commentary that analyzes eighty years of experience under the rules.

- (iii) OECD commentary on analogous portions of the OECD Model Tax Convention; and
- (iv) internationally recognized tax and accounting principles.

#### 4. Last Best Offer Arbitration

If the competent authorities and the taxpayer so direct, the Arbitral Tribunal may be required to choose among the last best offers of a proposed adjustment submitted by each Contracting State and the taxpayer.

#### 5. Interim Measures of Protection

Nothing contained in this Memorandum of Understanding or the provisions of the Convention shall prevent either Contracting State from seeking interim measures of protection such as pre-award attachment of assets.

#### 6. Multi-State Disputes

If the dispute implicates more than two countries that have submitted related transfer pricing disputes to arbitration, the Appointing Authority shall endeavor to obtain agreement of all relevant parties to a joinder of all relevant proceedings into a single arbitration before a single Tribunal all of whose members shall be nominated by the Appointing Authority.

#### 7. Majority Decisions

Decisions shall be taken by a majority of the arbitrators. Failing a result that commands a majority, the Presiding Arbitrator's decision shall be binding.

#### 8. Truncated Tribunal

In the event that any arbitrator dies, resigns, is successfully challenged for lack of independence or qualifications, or is otherwise unable to serve, the Appointing Authority shall appoint a successor as it deems appropriate. However, should a vacancy occur subsequent to the close of the evidentiary stage of the arbitration, the Appointing Authority may direct the remaining arbitrators to make a determination without a successor member of the tribunal.

#### 9. Tribunal Compensation

##### (a) Amount of Remuneration

##### Alternative 1

The Appointing Authority shall fix the arbitrators' compensation and assess its own administrative fee according to the scale currently adopted by the International Chamber of Commerce in Paris.

##### Alternative 2

The arbitrators' compensation shall be fixed on the basis of an hourly rate disclosed in advance of appointment, which shall not exceed US \$ XXX. The administrative fee charged by the Appointing Authority shall be disclosed to the Contracting States and the taxpayer at the time of appointment.

(b) Each of the Contracting States and the taxpayer shall be liable for one-third of the costs of the arbitration. Prior to the transmittal of the file to the arbitrators, each Contracting State and the taxpayer shall in equal portions deposit with the Appointing Authority an advance on costs to be fixed by the Appointing Authority, subject to later adjustment as appropriate. No award shall be issued without full payment of any advance on costs requested by the Appointing Authority.

(c) Should either Contracting State or the taxpayer refuse to pay its portion of the advance on costs, the other Contracting State or the taxpayer may make substitute payment on behalf of the defaulting party and shall be entitled to reimbursement therefore as the Arbitral Tribunal shall direct.

(d) At the time it issues an award, the Arbitral Tribunal may, if it deems appropriate, assess costs (including attorney's fees) against a Contracting State.

#### 10. Penalties

The Arbitral Tribunal shall have no authority to award penalties.

#### 11. Furnishing of Information

Each of the competent authorities and the taxpayer shall furnish to the Arbitral Tribunal all available documentation and information which it requests. If it determines that any party has failed to observe this obligation in good faith the Tribunal shall be entitled to draw negative inferences and/or assess costs against the non-complying party.

#### 12. Confidentiality

The arbitral proceedings, any documents or information furnished to the Arbitral Tribunal and any rulings shall be kept confidential by the Contracting States, the taxpayers and members of the Arbitral Tribunal. and shall not be disclosed except: (i) as necessary for recognition of the award; (ii) with the consent of all parties; or (iii) as required by law. Unless otherwise agreed by the Contracting States and the taxpayer, any award which is published shall be redacted to prevent disclosure of any confidential information. Upon the rendering of an award, each Contracting State and the taxpayer shall submit to the Arbitral Tribunal its proposed redactions, and the Tribunal shall decide which of these will be made.

#### 13. Relief Awarded

Unless authorized by the Contracting States no Arbitral Tribunal may render an award calculating national tax due or to be refunded.<sup>15</sup>

In the event that an issue before the arbitral tribunal will recur in future years, the award may grant declaratory relief with respect to such years, which shall be binding only to the extent that in such future years the relevant circumstances are not materially charged.

Unless authorized by the Contracting States and the taxpayer(s), no arbitral tribunal may decide ex aequo et bono or in amiable composition.

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<sup>15</sup> To this extent the award of the arbitral tribunal can be said to be declaratory in nature.

## **ANNEX 5: ICC ARBITRATION PROPOSAL**

### **Arbitration in International Tax Matters Bilateral Convention Article**

#### **Commission on Taxation**

The Commission on Taxation of the ICC prepared a Policy Statement concerning Arbitration in Tax Matters dated 3 May 2000 (the "ICC Policy Statement"). In order to assist in the implementation of arbitration in tax matters in conformity with the guidelines established in the ICC Policy Statement, the Commission has prepared a model article, which could be adopted in bilateral taxation conventions.

This draft Article is designed having regard to the OECD Model Convention for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital (the "OECD Model"). It could, with appropriate modifications, be adopted in bilateral tax conventions based on other models.

Some bilateral conventions contain very brief arbitration provisions that do not reflect many of the guidelines referred to in the ICC Policy Statement. This draft proposes a somewhat more expansive article to accommodate those guidelines.

Following the draft Article is a commentary that raises a number of issues for further consideration, including matters not fully resolved in the draft, and notes some possible variations or alternatives to the provisions in the draft Article. The commentary also briefly notes the relationship between the draft and provisions found in certain agreements, including in particular the EC Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises (the "EC Convention") and some United States bilateral tax conventions.

#### Article 25A - Arbitration

- 1) If a case has been presented to either competent authority under paragraph 1 of Article 25, the case shall be submitted to an arbitration board according to the provisions of this Article at the request of the person who presented the case (in this Article referred to as the "taxpayer") if the competent authority to which the case was presented has not either itself or by mutual agreement with the competent authority of the other Contracting State arrived at a solution within two years of the date on which the case was so presented or if the taxpayer considers that the solution which has been arrived at is not in accordance with the Convention.
- 2) A request for arbitration must be made by the taxpayer in writing within one year after the two year time limit referred to in paragraph 1 to the competent authority to which the case was presented and the request must include the taxpayer's agreement to be bound by the decision of the arbitration board.
- 3) The two-year time limit referred to in paragraph 1 shall be extended in the following circumstances:
  - a) The two-year limit may be waived by mutual agreement among the competent authorities, the taxpayer

and any associated enterprises the profits of which are relevant in determining that double taxation may have resulted (the taxpayer and such other enterprises being referred to in this Article as the "affected taxpayers").

b) If the case has also been submitted to a competent court or tribunal in either Contracting State, the two-year time limit shall be computed from the date on which a final judgment has been rendered and all delays for appeal therefrom have expired, or the date upon which the parties to such proceeding have definitively abandoned it.

4) The competent authorities shall establish an arbitration board for each specific case in the following manner:

a) An arbitration board shall consist of not less than three members. Each competent authority shall appoint the same number of members and these members shall agree on the appointment of the final member.

b) All the members of the arbitration board must be appointed within three months from the date on which the request for arbitration was made.

5) The competent authorities may agree on and instruct the arbitration board regarding specific rules of procedure not inconsistent with this Article. Otherwise, the arbitration board shall establish its own rules of procedure consistent with generally accepted principles of international arbitration.

6) The arbitration board shall be provided with information as follows:

a) Notwithstanding Article 26 (Exchange of Information), the competent authorities shall release to the arbitration board such information as is necessary for carrying out the arbitration procedure.

b) The arbitration board may require the affected taxpayers to produce information but subject to the limitations on production applicable under the domestic law applicable to them.

c) Arbitration board members (and their staffs) upon their appointment must agree in writing to abide by and be subject to the most restrictive confidentiality and disclosure provisions of both Contracting States and the Convention.

7) The affected taxpayers and their representatives shall be afforded the opportunity to submit relevant information, to present their oral or written arguments to the arbitration board and to respond to arguments or evidence submitted by the Contracting States, in accordance with the applicable procedural rules.

8) The taxpayer may, at any time, conclusively terminate the arbitration by notice to the arbitration board.

9) The arbitration board shall decide each specific case as follows:

a) The decision shall be made on the basis of the Convention, having regard to the domestic laws of the Contracting States and the principles of international law, with a view to eliminating double taxation.

b) The arbitration board shall adopt its opinion by simple majority.

c) The arbitration board shall deliver its opinion not more than one year from the date on which the matter was referred to it.

d) The arbitration board will provide to the competent authorities and to the affected taxpayers an explanation of its decision.

10) The decision of the arbitration board in a particular case shall be binding on both Contracting States and the taxpayer who presented the case to the competent authority, solely with respect to that case.

11) Costs for the arbitration proceedings will be borne in the following manner:

a) Each Contracting State shall bear the cost of remuneration for the member(s) appointed by it, as well as for its representation in the proceedings.

b) The affected taxpayers shall bear the cost of their representation in the proceedings.

- c) All other costs of the arbitration board shall be shared equally between the Contracting States.
- d) The arbitration board may decide on a different allocation of costs.

12) The competent authorities may agree to modify or supplement the procedures governing the arbitration board as set out in this Article; however, they shall continue to be bound by the general principles established herein.

13) Each Contracting State shall implement the conclusions of the arbitration board notwithstanding any other provision of domestic law, including otherwise applicable time limits.

#### Commentary to Draft Article 25.1

##### Paragraph 1

This paragraph defines the nature of cases which may give rise to arbitration, prescribes the delay allowed to the competent authorities before arbitration may be requested, establishes that arbitration is compulsory and sets out the taxpayer's right of initiative.

##### · Trigger event

Paragraph 1 is framed to complement the mutual agreement provision set forth in Article 25 of the OECD Model. The event which gives rise to a potential submission to arbitration is that the competent authority has not either itself or by mutual agreement with the other competent authority arrived at an appropriate solution to a matter presented under Article 25. The EU Convention speaks only of failure to reach an agreement but this paragraph follows the language of Article 25(2) of the OECD Model, which contemplates both unilateral and bilateral relief.

Arbitration may be invoked if the competent authorities fail to agree or, if they do agree, the taxpayer considers that the agreement is not in accordance with the convention. This is broader than the EU Convention, which mandates arbitration only where the competent authorities fail to reach an agreement that eliminates double taxation with respect to Article 9 issues.

##### · Time delay

The ICC Policy Statement emphasizes the importance of establishing a strict timetable. Generally, the possibility of arbitration should exist where the mutual agreement procedure has not yielded an appropriate solution within a prescribed period. A two-year limitation has been suggested in paragraph 1, the same as is adopted in the EU Convention and a number of bilateral conventions (e.g., France-Germany). A three-year period was adopted in the recent Germany-Austria convention.

Other aspects of the timetable for arbitration are addressed in paragraphs 2, 4(c) and 9(c).

##### · Compulsory arbitration

One of the fundamental guidelines established in the ICC Policy Statement is that arbitration should be compulsory. This is reflected by the mandatory language of paragraph 1.

##### · Right of initiative

Paragraph 1 provides that arbitration may be required where the taxpayer considers that an appropriate solution has not been reached. It was suggested in the ICC Policy Statement that other affected taxpayers (such as the associated person in the case of an Article 9 adjustment) should be permitted to request arbitration. This suggestion has not been retained in the draft Article. It would entail a number of complex procedural provisions. Furthermore, it is not obvious that a taxpayer who did not institute competent authority consideration under Article 25 should be afforded the right of initiative. The matter requires, however, further consideration.

· Exclusion for domestic law

Some conventions, notably a number of U.S. conventions, include a provision that excludes arbitration if the matter concerns the tax policy or domestic tax law of either Contracting State. This exclusion is not found in the EU Convention and has not been adopted.

It should be clear that the arbitration board interprets and applies the convention and does not make decisions regarding domestic law or tax policy as such. However, such domestic law or tax policy might well be taken into account in construing or applying the convention. There is, therefore, concern that the exclusion could create confusion or uncertainty as to the scope and jurisdiction of the arbitration board.

If such an exclusion is included in the article, it should be limited to cases that concern exclusively the tax policy or domestic law of a Contracting State and supplemented by a provision in paragraph 8 that would prohibit the arbitration board from making a decision on such tax policy or domestic law. In this way, a case would not be excluded from arbitration merely because it might be considered to include an element of domestic law, but the arbitration board would not have the power to decide the specific issue of domestic law.

Paragraph 2

Where the conditions of paragraph 1 are met, the taxpayer may request arbitration. Paragraph 2 establishes that such a request must be made within one year following the expiry of the two-year period allowed to the competent authorities for arriving at a solution. In addition, the taxpayer's right to initiate arbitration is conditioned on a written agreement to be bound by the results of the arbitration. This requirement is found in most bilateral conventions. See also paragraph 10, which confirms that the arbitration decision is binding on the taxpayer.

Paragraph 3

This paragraph contemplates two circumstances in which the two-year time limit stipulated in paragraph 1 shall be extended.

· Mutual agreement

Subparagraph (a) is similar to Article 7(4) of the EU Convention, requiring the agreement of both competent authorities and the affected taxpayers.

Affected taxpayers are the taxpayer who presented the case and any associated enterprises the profits of which are relevant in determining that there may have been double taxation. However, since the scope of arbitration is broader in this draft Article than in the EU Convention, further consideration is required as to whether the agreement of such an associated enterprise should, indeed, be required.

· Collateral proceedings

Extension is also provided (subparagraph (b)) in the event that collateral judicial or administrative proceedings have been commenced. This rule is based on Article 7(1), paragraph 2 of the EU Convention. Such collateral proceedings are not generally referred to in bilateral conventions, or in Article 25 of the OECD Model. Article 7(3) of the EU Convention provides additional rules relating to such proceedings.

Article 8 of the EU Convention provides for an exception from arbitration where judicial or administrative proceedings have resulted in a final ruling that by reason of actions which have given rise to the circumstances of the case any of the enterprises concerned is liable to a serious penalty. If such a ruling is being sought, the competent authorities are permitted to stay the arbitration proceedings. This provision has not been included in the draft.

The matter of collateral proceedings in general requires further consideration.

#### Paragraph 4

The next several paragraphs deal with the establishment of the arbitration board and its procedure. The EU Convention and bilateral conventions provide different rules, and different levels of detail, regarding the mechanics of arbitration.

With respect to the establishment of the arbitration board, the EU Convention and some bilateral conventions (e.g., the Germany-United States Convention) provide for an arbitration board of at least three members while other conventions fix the number of arbitrators at three- (e.g., France-Germany). This draft Article opts for the flexibility of the "at least three" solution. The draft does not reproduce the rather more detailed procedural provisions found in the EU Convention concerning other aspects of the establishment of the arbitration board, such as the identity of arbitrators and the choice of the chairman.

The drafting of subparagraphs (a) and (b) of paragraph 4 is based on the Germany-United States convention. However, that convention also includes a final sentence that has not been retained: "The competent authorities may issue further instructions regarding the criteria for selecting the other member(s) of the arbitration board." This sentence was not considered necessary given the other provisions of the draft Article, in particular paragraphs 5 and 12.

Subparagraph (c) is based on the France-Germany convention and reflects the guideline expressed in the ICC Policy Statement that a timetable for the arbitration should be prescribed. The specific choice of a three month delay requires further consideration. As well, the precise mechanism of choosing arbitrators if they are not named within this delay remains to be determined. The France-Germany convention contains a reference to the Permanent Arbitration Court, which may not be appropriate in the case of the draft Article.

#### Paragraph 5

This paragraph provides in general terms for a method whereby the rules of procedure for the arbitration may be set, looking first to the competent authorities and, absent direction from them, to the board itself. While it is based on the Germany-United States and Mexico-United States conventions, those conventions also specify that the competent authorities may stipulate certain specific matters that are expressly prescribed in this draft, such as time limits. Therefore, this paragraph 5 includes language clarifying the precedence of procedural rules provided in other paragraphs of the draft Article over any competent authority agreement regarding procedure.

#### Paragraph 6

The arbitration board must obtain information in order to carry out the arbitration. The ICC Policy Statement underscores the importance of preserving the confidentiality of taxpayer information, reflected in this paragraph 6.

Subparagraph (a) provides for the obtaining of information from the competent authorities. It is derived from a provision common in the arbitration provisions of bilateral conventions. However, those other provisions are normally facultative while subparagraph (a) of the draft is mandatory. This seems appropriate since participation in the arbitration by the Contracting States is also mandatory.

Subparagraph (b) provides for the obtaining of information from taxpayers. It protects them against production beyond the national requirements otherwise applicable.

Subparagraph (c) is based on the Germany-United States and Mexico-United States conventions. It underscores the importance of preserving confidentiality throughout the arbitration procedure. The standard of confidentiality to be applied is the highest of the three potentially applicable rules: those imposed by each of the two domestic legal systems and by the Convention itself.

#### Paragraph 7

The ICC Policy Statement underscores the importance of taxpayers' rights of representation before an arbitration board. Bilateral conventions, such as the Germany-United States convention, as well as the EU Convention (Article 10), provide somewhat more limited rights of representation than those set forth in paragraph 7.

While subparagraph 6(b) provides that affected taxpayers may be required to produce information, paragraph 7 provides them with a positive right to provide such information as they deem appropriate, even if not requested by the arbitration board or the competent authorities. In addition, affected taxpayers (defined in subparagraph 3(a)) are afforded a positive right to present oral and written arguments, and to respond to arguments or evidence submitted by the Contracting States.

#### Paragraph 8

Paragraph 1 provides taxpayers with a right of initiative. Paragraph 8 provides a right of termination of the arbitration by the initiating taxpayer, as suggested in the ICC Policy Statement. No such provision appears in bilateral conventions or the EU Convention.

#### Paragraph 9

This paragraph contains certain rules relating to the decisions of the arbitration board.

Subparagraph (a) confirms, in accordance with the ICC Policy Statement, that decisions should be based on law. The arbitration board should decide the case of double taxation presented with respect to the particular taxpayers, and not reflect "horse-trading" between Contracting States or other extraneous considerations. No such provision appears in bilateral conventions or the EU Convention.

Subparagraph (b) provides for decisions by simple majority, as in Article 11(2) of the EU Convention. No such rule is found in US and some other bilateral conventions. It could be considered unnecessary, a matter left to the general procedural rule in paragraph 5.

Subparagraph (c) sets a time limit on the arbitration, reflecting the concern expressed in the ICC Policy Statement that the process should proceed in a timely manner. This subparagraph is based on Article 11 of the EU Convention. The draft Article suggests a limit of one year. While this could be considered short in complex fiscal arbitrations, it was considered appropriate having regard to the fact-finding process which will have already occurred in the mutual agreement procedure. It is intended that the one-year period begin to run once the members of the arbitration board have been chosen.

Subparagraph (d) provides for a reasoned arbitration decision. The bilateral conventions that contain such a requirement refer to the explanation being provided to the competent authorities only. Given the taxpayer's right of initiation and the enhanced participation of affected taxpayers (as defined in subparagraph 3(a)) in the arbitration, it is appropriate in this draft Article that the reasons be provided to the affected taxpayers as well as to the competent authorities.

#### Paragraph 10

A fundamental recommendation in the ICC Policy Statement is that arbitration decisions should be binding on the Contracting States. This is reflected in paragraph 10. However, the draft Article has not retained the suggestion that the decision be binding on affected taxpayers other than the taxpayer initiating the arbitration. This matter requires further consideration, but it does not seem appropriate for other taxpayers to be bound.

The draft Article states that the decision is binding "solely" with respect to the particular case. Some conventions (such as the Germany-United States convention) contain an additional sentence regarding the weight to be given arbitration decisions in other cases, to the following effect:

While the decision of the arbitration board shall not have precedential effect, it is expected that such decisions ordinarily will be taken into account in subsequent competent authority cases involving the same taxpayer, affected taxpayers, the same issue(s), and substantially similar facts, and may also be taken into account in other cases where appropriate.

Such a sentence may be added where countries consider it appropriate.

#### Paragraph 11

The treatment of costs set forth is based generally on the Germany-United States and similar conventions. An alternative, simpler approach is to mandate an equal sharing of costs, as provided in Article 11(3) of the EU Convention. Subparagraph (b) is not contained in other models as taxpayer participation is not contemplated.

The Germany-United States convention includes a rule that provides that the taxpayer may be required to bear the costs of a Contracting State, and the taxpayer's agreement to bear the costs is a prerequisite to arbitration. The draft Article does not retain this provision. Instead, subparagraph (d) provides that the arbitration board make a final determination as to costs.

#### Paragraph 12

This paragraph is intended to ensure that necessary modifications to the full gamut of procedural rules set out in the draft Article may be agreed to by the competent authorities without requiring a protocol to the convention. See, for example, the German-United States convention and Article 11(2) of the EU Convention. This complements the more limited right of the competent authorities to determine arbitration procedure before the board, in paragraph 5.

#### Paragraph 13

An important issue in tax arbitration is the effectiveness and enforceability of decisions of the arbitration board. This paragraph is based on the recommendations in the ICC Policy Statement. No such provision is found in the US conventions or the EU Convention. The implication of paragraph 13 is that the Contracting States will take such steps as may be necessary, including changes to domestic law, to implement the arbitration decision.

The EU Convention makes provision for alternative action by the competent authorities, not necessarily in accordance with the arbitration decision, so long as it eliminates double taxation. This has not been retained in the draft Article because it is contrary to the guideline established in the ICC Policy Statement to the effect that the double taxation should be eliminated applying legal principles.

No reference is made in paragraph 13 to the payment of interest. It is appropriate that interest should be paid if, under domestic law, this would be the case had the same action been taken by the tax authorities of the Contracting State without regard to arbitration.

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