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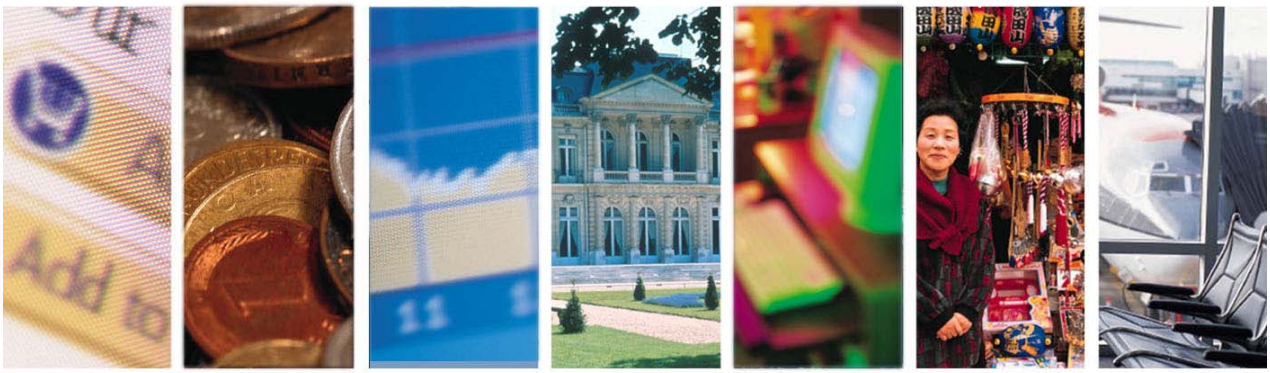

PROPOSALS FOR IMPROVING MECHANISMS FOR THE RESOLUTION OF TAX TREATY DISPUTES

Public discussion draft

February 2006

CENTRE FOR TAX POLICY AND ADMINISTRATION

1 February 2006

PROPOSALS FOR IMPROVING MECHANISMS FOR THE RESOLUTION OF TAX TREATY DISPUTES

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In July 2004, the OECD Committee on Fiscal Affairs released a progress report on its work on improving the resolution of cross-border tax disputes. The report, entitled "Improving the Process for Resolving International Tax Disputes" included various proposals aimed at improving the way that tax treaty disputes are resolved through the mutual agreement procedure ("MAP"). A number of these proposals referred to future work to be carried on by the Committee.

This note is the result of the follow-up work on these proposals that was carried on by the Joint Working Group that was set up by the Committee on Fiscal Affairs to examine ways of improving the effectiveness of the MAP, including the consideration of other dispute resolution techniques which might be used to supplement the operation of the MAP. It includes various draft changes to the OECD Model Tax Convention as well as a proposal for an online Manual on Effective Mutual Agreement Procedure ("MEMAP").

The OECD Committee on Fiscal Affairs has a well-established policy of consulting with business and other interested parties. As part of this policy, it has been decided that prior to any further discussion of the proposals included in this note, these should be issued in a draft for public comments. It is also proposed to have further consultation through a public consultation meeting, to be held in Tokyo on 13 March 2006. Further details of this meeting are available at www.oecd.org\ctp.

In order to be taken into account for that public consultation meeting, comments on the proposals relating to changes to the OECD Model Tax Convention that are included in this note should be sent in electronic form **before 3 March 2006** to:

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Comments sent after that date, **but before 30 April 2006**, will also be considered when finalising the OECD Model Tax Convention proposals included in this note.

The note also describes the proposed launching of a publicly available preliminary version of the MEMAP website by the time of the Tokyo consultation on 13 March 2006. Comments on the preliminary version of the MEMAP website should be sent in electronic form **before 30 June 2006** to the address shown above.

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PROPOSALS FOR IMPROVING MECHANISMS FOR THE RESOLUTION OF TAX TREATY DISPUTES

Introduction

1. On 27 July 2004, the OECD Committee on Fiscal Affairs released a progress report on its work on improving the resolution of cross-border tax disputes. The report, entitled "Improving the Process for Resolving International Tax Disputes"[1] included 31 proposals (reproduced in Annex 1) aimed at improving the way that tax treaty disputes are resolved through the mutual agreement procedure.

2. A number of these proposals were directed at tax administrations. Some of these were aimed at ensuring greater transparency through the dissemination of individual countries' information concerning the organisation of competent authority functions and the procedures to be followed in mutual agreement cases. As a result of work done on these proposals, such information is now provided through the OECD website, which includes a periodically updated list of "country profiles on mutual agreement procedures" for both OECD and non-OECD countries.[2]

3. Other proposals required the Committee to pursue its work through the Joint Working Group (the "JWG") that had prepared the 2004 Progress Report and that had been set up to examine ways of improving the effectiveness of the MAP. This note is the result of that follow-up work. It includes various draft changes to the OECD Model Tax Convention as well as a proposal for a Manual on Effective Mutual Agreement Procedure. In accordance to the Committee's well-established policy of consulting with business and other interested parties, the Committee has decided that prior to a further discussion of these proposals, these should be issued in a draft for public comments. It is also proposed to have further consultation through a public consultation meeting, to be held in Tokyo on 13 March 2006.

4. Two of the most important proposals included in the 2004 Progress Report dealt with the use of supplementary dispute resolution mechanisms, and in particular arbitration, to resolve issues that prevent competent authorities from reaching a mutual agreement. Following work done pursuant to these proposals, section A of this note presents an important change to the OECD Model Tax Convention that institutes an arbitration process to deal with unresolved issues that prevent competent authorities from reaching a mutual agreement.

5. Other proposals in the 2004 Progress Report dealt with various issues that may arise in the course of a mutual agreement procedure. Section B includes the changes that the JWG proposes to make to the Commentary on the OECD Model Tax Convention to address these issues.

6. Many of the proposals of the 2004 Progress Report referred to the development of a Manual on Effective Mutual Agreement Procedure, which would explain the various stages of the mutual agreement

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1. Available at http://www.oecd.org/dataoecd/44/6/33629447.pdf.

2. These can be consulted at: http://www.oecd.org/document/31/0,2340,en_2649_33747_29601439_1_1_1_1,00.html.

procedure, discuss various issues related to that procedure and, where appropriate, describe best practices. Section C presents a proposal for that Manual on Effective Mutual Agreement Procedure.

7. Section D, finally, deals with the follow-up to other proposals of the 2004 Progress Report.

A. Arbitration of unresolved issues in a mutual agreement case

8. The existing MAP process provides a generally effective and efficient method of resolving international tax disputes. However, there will 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 in a particular situation that the taxation by both States is in accordance the treaty. Since the MAP process as currently structured does not *require* the countries to come to a common understanding of the treaty, but only that they endeavour to agree, the result can be unrelieved double taxation or "taxation not in accordance with the Convention".

9. The inability of the current MAP process to provide for all steps possible to facilitate a final resolution of issues arising under treaties 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 competent authorities to take all steps necessary to ensure a speedy resolution of the issues involved.

10. 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, principled, fair and objective 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. Recourse to these techniques, however, must be an integral part of the mutual agreement procedure and should not constitute an alternative route to solving tax treaty disputes between States, which would risk undermining the effectiveness of the mutual agreement procedure. Thus, as soon as competent authorities have reached an agreement on how to solve a particular case, there is no further need for applying such techniques in that case.

11. 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.

12. Section III of the 2004 Progress Report discussed supplementary dispute resolution. It stressed the importance of developing further the supplementary dispute resolution process as part of improving MAP generally and contained two proposals for future work in this area. Proposal 15 dealt with the mandatory submission of unresolved MAP cases to supplementary dispute resolution mechanisms and proposal 16 with the mandatory resolution of such cases.

13. At a meeting held in June 2005, the Joint Working Group agreed that work on these proposals should be pursued based on the following general approach:

- To add a new paragraph to Article 25 of the Model Tax Convention to provide for the mandatory resolution of unresolved MAP cases. The new paragraph would set out the principle that issues

arising from a MAP case that are unresolved after a period of two years could be submitted to arbitration at the request of the taxpayer who initiated the case. It would also provide that the mode of application of that principle would be determined by mutual agreement, thereby avoiding the need to set out the procedural details in the Article itself. In order to acknowledge that some countries might be unable to agree to such a paragraph because of constitutional, legal or other reasons, a footnote to that effect would be added to the paragraph.

- To draft a detailed Commentary to that paragraph that would contain a discussion of when it is appropriate to add the new paragraph and would indicate that countries which cannot agree to it are free not to include it in their conventions. The Commentary would also discuss the contents of the procedural mutual agreement that would provide for the details of the application of the mandatory supplementary dispute resolution process. In addition, the Commentary would indicate that countries could use such a procedural agreement to implement a process of supplementary dispute resolution under the existing wording of Article 25, which is found in most existing treaties.

Proposed paragraph

14. The following is the proposed new paragraph which the JWG has drafted on the basis of these decisions:

Add the following new paragraph 5 to Article 25:

"5. Where, under paragraph 1, a person has presented a case to the competent authority of a Contracting State and the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State, any unresolved issues arising from the case shall be submitted to arbitration if the person so requests. These unresolved issues shall not, however, be submitted to arbitration if any person directly affected by the case is still entitled, under the domestic law of either State, to have courts or administrative tribunals of that State decide the same issues or if a decision on the same issues has already been rendered by such a court or administrative tribunal. The arbitration decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.[1]

[Text of the footnote, which would appear on the same page:]

1. In some States, national law, policy or administrative considerations may not allow or justify the type of dispute resolution envisaged under this paragraph. In addition, some countries may only wish to include this paragraph in treaties with certain countries. For these reasons, the paragraph should only be included in the Convention where each State concludes that it would be appropriate to do so based on the factors described in paragraph 46 of the Commentary on the paragraph."

Proposed Commentary on the new paragraph

15. The following is a revised draft of the Commentary on the new paragraph (other consequential changes, such as amending paragraphs 4 and 5 of the Commentary on Article 25, might also be made to the Commentary). For ease of reference, Annex 2 shows the various deadlines of the arbitration process suggested in the Commentary below.

Replace paragraphs 45 to 48 of the Commentary on Article 25 and the heading preceding them by the following new heading and paragraphs 45 to 99 (and renumber existing paragraphs 49 to 55 as paragraphs 100 to 106):

~~"Final observations~~

~~45. On the whole, the mutual agreement procedure has proved satisfactory. Treaty practice shows that Article 25 has generally represented the maximum that Contracting States were prepared to accept. It must, however, be admitted that this provision is not yet entirely satisfactory from the taxpayer's viewpoint. This is because the competent authorities are required only to seek a solution and are not obliged to find one (cf. paragraph 26 above). The conclusion of a mutual agreement depends to a large extent on the powers of compromise which the domestic law allows the competent authorities. Thus, if a convention is interpreted or applied differently in two Contracting States, and if the competent authorities are unable to agree on a joint solution within the framework of a mutual agreement procedure, double taxation is still possible although contrary to the sense and purpose of a convention aimed at avoiding double taxation.~~

~~46. It is difficult to avoid this situation without going outside the framework of the mutual agreement procedure. The first approach to a solution might consist of seeking an advisory opinion: the two Contracting States would agree to ask the opinion of an impartial third party, although the final decision would still rest with the States.~~

~~47. The provisions embodied in this Convention, as well as the Commentary related thereto, are the result of close international joint work within the Committee on Fiscal Affairs. A possibility near at hand would be to call upon the Committee on Fiscal Affairs to give an opinion on the correct understanding of the provisions where special difficulties of interpretation arise as to particular points. Such a practice, which would be in line with the mandate and aims of the Committee on Fiscal Affairs, might well make a valuable contribution to arriving at a desirable uniformity in the application of the provisions.~~

~~48. Another solution is that of arbitration. This is the solution adopted by the Member States of the European Communities through their multilateral Arbitration Convention, which was signed on 23 July 1990 and which provides that certain cases of double taxation that have not been solved through the mutual agreement procedure must be submitted to an arbitration procedure. Also, some recent bilateral conventions provide that the Contracting States may agree to submit unresolved disagreements to arbitration.~~

Paragraph 5

45. This paragraph provides that, in the rare cases where the competent authorities are unable to reach an agreement under paragraph 2, the unresolved issues will, at the request of the person who presented the case, be solved through an arbitration process. The arbitration process provided for by the paragraph is not an alternative or additional recourse: where the competent authorities have reached an agreement on how to solve a case, there are no unresolved issues that can be brought to arbitration even if the person who made the mutual agreement request does not consider that the agreement reached by the competent authorities provides a proper solution to the case. The paragraph is, therefore, an extension of the mutual agreement procedure that serves to enhance the effectiveness of that procedure by ensuring that where the competent authorities cannot reach an agreement, a final resolution of the case will still be possible through an arbitration procedure.

46. It is recognised, however, that in some States, national law, policy or administrative considerations may not allow or justify the type of arbitration process provided for in the paragraph. For example, there may be constitutional barriers preventing arbitrators from deciding tax disputes. In addition, some countries may only be in a position to include this paragraph in treaties with particular countries. For these reasons, the paragraph should only be included in the Convention where each State concludes that the process is capable of effective implementation.

46.1 Similarly, some States may wish to include the paragraph 5 but limit its application to a more restricted range of cases. For example, access to arbitration would only be available in cases which were primarily factual in nature.

47. Some States may also consider that a person should not have access to arbitration because that person has committed a serious violation of the domestic law of a Contracting State during the determination of his tax liability. Such States are free to add the following paragraph to the Article to prevent a request for arbitration in such cases:

> "Notwithstanding paragraph 5
>
> *a*) a person may not request that unresolved issues be submitted to arbitration if, before that request is made, serious penalties have been imposed on that person in a Contracting State because that person has violated the domestic law of that Contracting State as regards any aspect of the determination or the collection of the taxes which may be affected by these unresolved issues, and
>
> *b*) a State is not bound by an arbitration decision as regards the taxation of a person if, before that decision is rendered, serious penalties have been imposed on that person in a Contracting State because that person has violated the domestic law of that Contracting State as regards any aspect of the determination or the collection of the taxes which may be affected by the unresolved issues that were submitted to arbitration."

States that wish to include a paragraph drafted along these lines should be careful not to prevent access to arbitration where a penalty has been imposed on a taxpayer merely because he took a different, but not unreasonable, interpretation of the treaty. At a minimum, these States should clarify what constitute "serious penalties" for the purpose of that paragraph.

48. Where two Contracting States that have not included the paragraph in their Convention wish to implement an arbitration process for general application or to deal with a specific case, it is still possible for them to do so by mutual agreement. In that case, the competent authorities can conclude a mutual agreement along the lines of the sample wording presented in paragraph 60 below, to which they would add the following first paragraph:

> "1. Where, under paragraph 1 of Article 25 of the Convention, a person has presented a case to the competent authority of a Contracting State and the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State, any unresolved issues arising from the case shall be submitted to arbitration in accordance with the following paragraphs if the person so requests. These unresolved issues shall not, however, be submitted to arbitration if any person directly affected by the case is still entitled, under the domestic law of either State, to have courts or administrative tribunals of that State decide the same issues or if a decision on the same issues has already been rendered by such a court or administrative tribunal. The competent authorities hereby agree to consider themselves bound by the arbitration decision and to resolve the case pursuant to paragraph 2 of Article 25 on the basis of that decision."

This agreement would go on to address the various structural and procedural issues discussed in paragraphs 61 to 98. Whilst the competent authorities would thus be bound by such process, such agreement would be given as part of the mutual agreement procedure and would therefore only be effective as long as the competent authorities continue to agree to follow that process to solve cases that they have been unable to resolve through the traditional mutual agreement procedure process.

49. In addition, Contracting States that have not included the paragraph in their Convention may wish to implement a process that will merely provide an independent non-binding opinion to the competent authorities. This possibility of referring a case to a third party was already anticipated in paragraphs 46 and 47 of the Commentary as it read before [2007]. As in the case described in the previous paragraph, this could be done through the conclusion of a mutual agreement that would usefully spell out the procedure in advance and in more detail, thus informing both taxpayers and tax authorities of the nature of the process to be followed. In that case, however, the agreement would expressly indicate that the decision reached would not be binding on the States but would only be advisory.

50. Paragraph 5 provides that a person who has presented a case to the competent authority of a Contracting State pursuant to paragraph 1 may request that any unresolved issues arising from the case be submitted to arbitration. This request may be made at any time after a period of two years that begins when the case is presented to the competent authority of the other Contracting State. Recourse to arbitration is therefore not automatic; the person that presented the case may prefer to wait beyond the end of the two-year period (for example, to allow the competent authorities more time to resolve the case under paragraph 2) or simply not to pursue the case. States are free to provide that, in certain circumstances, a longer period of time will be required before the request can be made.

51. As drafted, paragraph 5 only provides for arbitration of unresolved issues arising from a request made under paragraph 1 of the Article. States wishing to extend the scope of the paragraph to also cover mutual agreement cases arising under paragraph 3 of the Article are free to do so by drafting the paragraph as follows (and by making the necessary modifications to the mutual agreement that will settle the mode of application of that paragraph):

> "5. Where the competent authorities are unable to reach an agreement to conclude a case within two years from the presentation of the case by a person pursuant to paragraph 1, or, where the case arises under paragraph 3, within two years from the date where the competent authority of one Contracting State first presented the case to the competent authority of the other Contracting State, any unresolved issues arising from the case shall be submitted to arbitration if the person or**,** if the case arises under paragraph 3, one of the competent authorities so requests. These unresolved issues shall not, however, be submitted to arbitration if any person directly affected by the case is still entitled, under the domestic law of either Contracting States, to have courts or administrative tribunals of these States decide the same issues or if a decision on the same issues has already been rendered by such a court or administrative tribunal. The arbitration decision shall be binding on both States and shall be implemented notwithstanding any time limits in the domestic laws of the Contracting States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph."

51.1. In some States, it may be possible for the competent authorities to deviate from a court decision on a particular issue arising from the case presented to the competent authorities. Those

States should therefore be able to omit the phrase "or if a decision on the same issues has already been rendered by such a court or administrative tribunal" from the paragraph.

52. The presentation of the case to the competent authority of the other State, which is the beginning of the two-year period referred to in the paragraph, may be made by the person who presented the case to the competent authority of the first State under paragraph 1 of Article 25 (e.g. by presenting the case to the competent authority of the other State at the same time or at a later time) or by the competent authority of the first State, who would contact the competent authority of the other State pursuant to paragraph 2 if it is not itself able to arrive at a satisfactory solution of the case. For the purpose of determining the start of the two-year period, a case will only be considered to have been presented to the competent authority of the other State if sufficient information has been presented to that competent authority to allow it to decide whether the objection underlying the case appears to be justified. The mutual agreement providing for the mode of application of paragraph 5 (see below) should specify which type of information will normally be sufficient for that purpose.

53. The paragraph also deals with the relationship between the arbitration process and rights to domestic remedies. For the arbitration process to be effective and to avoid the risk of conflicting decisions, a person should not be allowed to pursue the arbitration process if the same issues have been or could be litigated in domestic courts or administrative tribunals. Thus the paragraph provides that

a) a person will not be entitled to have an issue decided by arbitration as long as recourse to domestic courts or tribunals is still available, thus ensuring that an issue decided under the arbitration cannot be subsequently litigated in such courts or tribunals; and

b) a person shall not have the right to bring to arbitration an issue that has already been decided by a domestic court or tribunal.

54. The first restriction above will apply even if the person who initiated the mutual agreement procedure is not entitled to have recourse to domestic courts or tribunals on the relevant issues, as long as a "person directly affected by the case" is still entitled to such domestic recourse. For this purpose, a "person directly affected by the case" includes not only the person who has initiated the mutual agreement procedure but also any other person, such as a related company, the tax liability of which would be directly affected by a decision on the relevant issues. Similarly, the second restriction above will apply regardless of whether or not the person who initiated the mutual agreement procedure was a party to the procedure that resulted in the decision rendered by a domestic court or administrative tribunal on the relevant issues.

55. As indicated in paragraph 12 above, a person may present a case to the competent authority of a Contracting State even though the taxation considered by that person to be "not in accordance with the Convention" has not yet been charged or notified to that person. In such a case, however, the person will usually be entitled to have domestic courts or administrative tribunals deal with the issue once taxation is charged or notified. For that reason, it will not be possible to submit that case to arbitration as long as the person having presented the case is entitled to have the matter dealt by domestic courts or administrative tribunals after taxation is charged or notified.

56. Paragraph 5 provides that the arbitration decision shall be binding on both States. Thus, the taxation of any person directly affected by the case will have to conform with the decision reached on the issues submitted to arbitration and there is no need for detailed implementation process or principles such as those applicable to the implementation of commercial arbitration

agreements. In practice, the decision will be implemented by having the competent authorities solving the case presented under the mutual agreement on the basis of the answers provided by the arbitration decision and, where necessary, adjusting accordingly the taxation of the persons directly affected by the case.

57. The decision, however, is only binding with respect to the specific issues submitted to arbitration. Whilst nothing would prevent the competent authorities from solving other similar cases (including cases involving the same persons but different taxable periods) on the basis of the decision, there is no obligation to do so and each State therefore has the right to adopt a different approach to deal with these other cases.

58. Some States may wish to allow the competent authorities to depart from the arbitration decision, provided that they can agree on a different solution (this, for example, is allowed under Article 12 of the EU Arbitration Convention). States wishing to do so are free to amend the third sentence of the paragraph as follows:

> "[…] Unless the competent authorities and the persons directly affected by the case agree on a different solution within six months after the decision has been communicated to them, the arbitration decision shall be binding on both States and shall be implemented notwithstanding any time limits in the domestic laws of these States."

59. The last sentence of the paragraph leaves the mode of application of the arbitration process to be settled by mutual agreement. That agreement should set out the structural and procedural rules to be followed in applying the paragraph, taking into account the paragraph's requirement that the arbitration decision be binding on both States. Ideally, that agreement should be drafted at the same time as the Convention so as to be signed, and to apply, immediately after the paragraph becomes effective. Also, since the agreement will provide the details of the process to be followed to bring unresolved issues to arbitration, it would be important that this agreement be made public.

60. The following is a sample form of agreement that the competent authorities may use as a basis for a mutual agreement to implement the arbitration process. Paragraphs 61 to 98 below discuss the various provisions of the agreement and, in some cases, put forward alternatives.

Mutual agreement on the implementation of paragraph 5 of Article 25

The competent authorities of [State A] and [State B] have entered into the following mutual agreement to provide for the mode of application of the arbitration process provided for in paragraph 5 of Article 25 of the [title of the Convention], which entered into force on [date of entry into force].

1. Request for submission of case to arbitration. A request that unresolved issues arising from a mutual agreement case be submitted to arbitration pursuant to paragraph 5 of Article 25 of the Convention (the "request for arbitration") shall be made in writing and sent to one of the competent authorities. The request shall contain sufficient information to identify the case. The request shall also be accompanied by a written statement by each of the persons who either made the request or is directly affected by the case that that person is no longer entitled, under the domestic law of either State, to have courts or administrative tribunals of these States decide the same issues, or that the person renounces irrevocably to any such recourse that is still available, that no decision on the same issues has already been rendered by such a court or administrative tribunal and that the person renounces irrevocably any right to have

the arbitration decision challenged in courts or administrative tribunals of these States, except for the reasons mentioned in paragraph 15 below. Within 10 days of the receipt of the request, the competent authority who received it shall send a copy of the request and the accompanying statements to the other competent authority.

2. Time for submission of the case to arbitration. A request for arbitration may only be made after two years from the date on which a case presented to the competent authority of one Contracting State under paragraph 1 of Article 25 has also been presented to the competent authority of the other State. For this purpose, a case shall be considered to have been presented to the competent authority of the other State only if the following information has been presented: *[the necessary information and documents will be specified in the agreement]*.

3. Terms of Reference. Within three months after the request for arbitration has been received by both competent authorities, the competent authorities shall agree on the questions to be resolved by the arbitration panel and communicate them in writing to the person who made the request for arbitration. This will constitute the "Terms of Reference" for the case. Notwithstanding the following paragraphs of this agreement, the competent authorities may also, in the Terms of Reference, provide procedural rules that are additional to, or different from, those included in these paragraphs and deal with such other matters as are deemed appropriate.

4. Selection of arbitrators. Within three months after the Terms of Reference have been received by the person who made the request for arbitration, the competent authorities shall each appoint one arbitrator. During the same period, they shall also, by common consent, appoint a third arbitrator who will act in total neutrality and independence and who will be the Chair of the arbitral panel. If they fail to appoint a third arbitrator by common consent, that third arbitrator will be appointed by the other two arbitrators within one month from the end of the three-month period referred to in the first sentence of this paragraph. If, at the end of that one-month period, one or more of the 3 arbitrators have not yet been chosen, the arbitrators not yet appointed shall be appointed by the Director of the OECD Centre for Tax Policy and Administration within 10 days of receiving a request to that effect from the person who made the request for arbitration. The same procedure shall apply with the necessary adaptations if for any reason it is necessary to replace an arbitrator after the arbitral process has begun. Unless the Terms of Reference provide otherwise, the remuneration of any arbitrator not appointed exclusively by one competent authority shall be determined as follows …. *[the mode of remuneration should be described here; one possibility would be to refer to the method used in the Code of Conduct on the EC Arbitration Convention]*

5. Streamlined arbitration process. If the competent authorities so indicate in the Terms of Reference, the following rules shall apply to a particular case notwithstanding paragraphs 4, 10 and 14 of this agreement:

a) Within one month after the Terms of Reference have been received by the person who made the request for arbitration, the two competent authorities shall, by common consent, appoint one arbitrator who will act in total neutrality and independence. If, at the end of that period, the arbitrator has not yet been appointed, he will be appointed by the Director of the OECD Centre for Tax Policy and Administration, within 10 days of receiving a request to that effect from the person who made the request referred to in paragraph 1. The remuneration of the arbitrator shall be determined as follows … [*the mode of*

remuneration should be described here; one possibility would be to refer to the method used in the Code of Conduct on the EC Arbitration Convention]

b) Within two months from the appointment of the arbitrator, each competent authority will present in writing to the arbitrator its own reply to the questions contained in the Terms of Reference.

c) Within one month from having received the last of the replies from the competent authorities, the arbitrator will decide each question included in the Terms of Reference in accordance with one of the two replies received from the competent authorities as regards that question and will notify the competent authorities of the choice, together with short reasons explaining that choice. Such decision will be implemented as provided in paragraph 16.

6. Eligibility and appointment of arbitrators. Any person, including a government official of a Contracting State, may be appointed as an arbitrator, unless that person has been involved in prior stages of the case that results in the arbitration process. An arbitrator will be considered to have been appointed when a letter confirming that appointment has been signed both by the person or persons who have the power to appoint that arbitrator and by the arbitrator himself.

7. Communication of information and confidentiality. For the sole purposes of the application of the provisions of Articles 25 and 26, and of the domestic laws of the Contracting States, concerning the communication and the confidentiality of the information related to the case that results in the arbitration process, each arbitrator shall be designated as authorised representative of the competent authority that has appointed that arbitrator or, if that arbitrator has not been appointed exclusively by one competent authority, of the competent authority of the Contracting State to which the case giving rise to the arbitration was initially presented.

8. Failure to provide information in a timely manner. Notwithstanding paragraphs 4 and 5, where both competent authorities agree that the failure to resolve an issue within the two-year period provided in paragraph 5 of Article 25 is mainly attributable to the failure of a person directly affected by the case to provide relevant information in a timely manner, the competent authorities may postpone the nomination of the arbitrator for a period of time corresponding to the delay in providing that information.

9. Procedural and evidentiary rules. Subject to this agreement and the Terms of Reference, the arbitrators shall adopt those procedural and evidentiary rules that they deem necessary to answer the questions set out in the Terms of Reference. They will have access to all information necessary to decide the issues submitted to arbitration, including confidential information.

10. Participation of the person who requested the arbitration. The person who made the request for arbitration may, either directly or through his representatives, present his position to the arbitrators in writing and, with the permission of the arbitrators, present his position orally during arbitration meetings.

11. Logistical arrangements. Unless agreed otherwise by the competent authorities, the competent authority to which the case giving rise to the arbitration was initially presented will be responsible for the logistical arrangements for the meetings of the arbitral panel and will provide the administrative personnel necessary for the conduct of

the arbitration procedure. The administrative personnel so provided will report only to the Chair of the arbitration panel concerning any matter related to that procedure.

12. Costs. Unless agreed otherwise by the competent authorities:

a) each competent authority and the person who requested the arbitration will bear the costs related to his own participation in the arbitration proceedings (including travel costs and costs related to the preparation and presentation of his views);

b) each competent authority will bear the remuneration of the arbitrator appointed exclusively by that competent authority, or appointed by the Director of the OECD Centre for Tax Policy and Administration because of the failure of that competent authority to appoint that arbitrator, together with that arbitrator's travel, telecommunication and secretariat costs;

c) the remuneration of the other arbitrators and their travel, telecommunication and secretariat costs will be borne equally by the two Contracting States;

d) costs related to the meetings of the arbitral panel and to the administrative personnel necessary for the conduct of the arbitration procedure will be borne by the competent authority to which the case giving rise to the arbitration was initially presented; and

e) all other costs (including costs of translation and of recording the proceedings) related to expenses that both competent authorities have agreed to incur, will be borne equally by the two Contracting States.

13. Applicable Legal Principles. The arbitrators shall decide the issues submitted to arbitration in accordance with the applicable provisions of the treaty and, subject to these provisions, of those of the domestic laws of the Contracting States. Issues of treaty interpretation will be decided by the arbitrators in light of the principles of interpretation incorporated in Articles 31 to 34 of the *Vienna Convention on the Law of Treaties*, having regard to the Commentaries of the OECD Model Tax Convention as periodically amended, as explained in paragraphs 28 to 36.1 of the Introduction to the OECD Model Tax Convention. Issues related to the application of the arm's length principle should similarly be decided having regard to the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The arbitrators will also consider any other sources which the competent authorities may expressly identify in the Terms of Reference.

14. Arbitration decision. Where more than one arbitrator has been appointed, the arbitration decision will be determined by a simple majority of the arbitrators. The decision must be communicated to the competent authorities and the person who made the request for arbitration within six months from the date on which the last of the arbitrators has been appointed. In the event that the decision has not been communicated to the competent authorities within that period, the competent authorities shall, by mutual consent, either extend that period for a period not exceeding six months or appoint new arbitrators. Unless otherwise provided in the Terms of Reference, the decision of the arbitral panel will be presented in writing and shall indicate the sources of law relied upon and the reasoning which led to its result. With the permission of the person who made the request for arbitration and both competent authorities, the decision of the arbitral panel will be made public in redacted form without mentioning the names of the parties involved or any details that might disclose their identity and with the understanding that the decision has no formal precedential value.

15. Final nature of the decision. The arbitration decision shall be final, unless that decision is found to be unenforceable by the courts of one of the Contracting States because of a violation of paragraph 5 of Article 25 or of any procedural rule included in the Terms of Reference or in this agreement that may reasonably have affected the decision. If a decision is found to be unenforceable for one of these reasons, the request for arbitration shall be considered not to have been made and the arbitration process shall be considered not to have taken place (except for the purposes of paragraphs 7 "Communication of information and confidentiality" and 12 "Costs").

16. Implementing the arbitration decision. The competent authorities will implement the arbitration decision within six months from the communication of the decision to them by reaching an agreement on the case that led to the arbitration and by applying that agreement to the taxation of the taxpayers directly affected by the case.

17. Where no arbitration decision will be provided. Notwithstanding paragraph 14, where, at any time after a request for arbitration has been made and before the arbitrators have delivered a decision to the competent authorities and the person who made the request for arbitration, the competent authorities notify in writing the arbitrators and that person that they have solved all the unresolved issues described in the Terms of Reference, the case shall be considered as solved under the mutual agreement procedure and no arbitration decision shall be provided.

This agreement applies to any request for arbitration made pursuant to paragraph 5 of Article 25 of the Convention after that provision has become effective.

[Date of signature of the agreement]

[Signature of the competent authority of each Contracting State]

The request for arbitration

61. Paragraph 1 of the sample agreement provides the manner in which a request for arbitration should be made. Such request should be presented in writing to one of the competent authorities involved in the case. That competent authority should then inform the other competent authority within 10 days of the receipt of the request.

62. In order to determine that the conditions of paragraph 5 of Article 25 are met (see paragraph 53 above), the request should be accompanied by statements indicating that the persons directly affected by the case are no longer entitled to domestic remedies concerning the issues submitted to arbitration, or renounce irrevocably to any such recourse that may still be available, that no decision on these issues has already been rendered by domestic courts or tribunals and, finally, that these persons also renounce irrevocably any right to have the arbitration decision challenged in courts or administrative tribunals of the States except for the reasons mentioned in paragraph 15 of the sample agreement.

63. In some States, it may be impossible for a taxpayer to give up judicial remedies, and, even if he agrees to do so, it may be impossible to enforce that agreement. Such States should omit the words "or renounce irrevocably to any such recourse still available" since it would then

be impossible, through such renunciation, to meet the condition, included in paragraph 5 of Article 25, that persons directly affected by the case no longer be entitled to domestic remedies. Similarly, these States should omit the phrase "and that the person renounces irrevocably any right to have the arbitration decision challenged in courts or administrative tribunals of these States, except for the reasons mentioned in paragraph 15 below". In such a case, it would be appropriate to amend paragraph 15 of the sample agreement to provide that if a person directly affected by the decision successfully challenged the arbitration decision through domestic judicial proceedings, the case that led to the arbitration shall be considered not to have been presented to the competent authorities (except for the purposes of paragraphs 7, which deals with communication of information and confidentiality, and 12, which deals with costs), and the arbitration decision will be considered not to have been rendered.

64. Since the arbitration process is an extension of the mutual agreement procedure that is intended to deal with cases that cannot be solved under that procedure, it would seem inappropriate to ask the person who makes the request to pay in order to make such request or to reimburse the expenses incurred by the competent authorities in the course of the arbitration proceedings. Unlike taxpayers' requests for rulings or other types of advance agreements, where a charge is sometimes made, providing a solution to disputes between the Contracting States is the responsibility of these States for which they in general should bear the costs.

65. A request for arbitration may not be made before two years from the date when a mutual agreement case presented to the competent authority of a Contracting State has also been presented to the competent authority of the other Contracting State. Paragraph 2 of the sample agreement provides that for this purpose, a case shall only be considered to have been presented to the competent authority of that other State if the information specified in that paragraph has been so provided. The paragraph should therefore include a list of the information required; in general, that information will correspond to the information and documents that was required to initiate the mutual agreement procedure**.**

Terms of Reference

66. Paragraph 3 of the sample agreement refers to the "Terms of Reference", which is the document in which the competent authorities set forth the questions to be resolved by the arbitrators. That document must be provided to the person who made the request for arbitration within three months after the request for arbitration has been received by both competent authorities.

67. The procedural rules provided for in the sample agreement shall apply unless the competent authorities provide otherwise in the Terms of Reference. It is therefore possible for the competent authorities, through the Terms of Reference, to depart from any of these rules or to provide for additional rules in a particular case.

Streamlined procedure

68. The normal procedure provided for by the sample agreement allows the consideration of questions of either law or fact, as well as of mixed questions of law and fact. Where legal issues are involved, it is important that the arbitrators support their decision with the reasoning leading to it. Showing the method through which the decision was reached is important in assuring acceptance of the decision by all parties.

69. In some cases, however, the unresolved issues may be primarily factual and the decision will be a statement of the factual premises on which the appropriate legal principles should then be applied by the competent authorities. This will often be the situation in transfer pricing cases, where the unresolved issue may be simply the determination of an arm's length transfer price or range of prices. Paragraph 5 of the sample agreement provides a streamlined procedure which the competent authorities may wish to apply, in particular to deal with such cases. That procedure, which will then override other procedural rules of the sample agreement, takes the form of the so-called "last best offer" approach, under which each competent authority is required to give to an arbitrator appointed by common consent his own reply to the questions included in the Terms of Reference and the arbitrator simply chooses one of the submitted replies. The competent authorities may, as for most procedural rules, amend or supplement the streamlined procedure through the Terms of Reference applicable to a particular case.

Selection of arbitrators

70. Paragraph 4 of the sample agreement describes how arbitrators will be selected unless the Terms of Reference drafted for a particular case provide otherwise (for instance, by opting for the streamlined procedure described in the preceding paragraph). The two competent authorities will each appoint one arbitrator and, by common consent, will appoint the third arbitrator, who will act in total neutrality and independence and who will be the Chair of the arbitral panel. These appointments must be made within three months after the Terms of Reference have been received by the person who made the request for arbitration. If the competent authorities do not appoint that third arbitrator during that period, the third arbitrator will be appointed by the other two arbitrators within the next following month. If one or more of the arbitrators have not been appointed in accordance with the preceding rules, the paragraph provides that they will be appointed by the Director of the OECD Centre for Tax Policy and Administration. The competent authorities may, of course, provide for another way to address this rare situation but it seems important to provide for a mechanism to solve a deadlock in the selection of the arbitrators.

71. There is no need for the agreement to stipulate any particular qualifications for an arbitrator as it will be in the interests of the competent authorities to have qualified and suitable persons act as arbitrators. The agreement does not require the independence of the arbitrators appointed exclusively by each competent authority but does so with respect to the one that the competent authorities appoint by common consent. There may be advantages in having representatives of each Contracting State appointed as arbitrators as they would be familiar with the issues. Once an arbitrator has been appointed, it should be clear that his role is to decide the case on a neutral and objective basis; he is no longer functioning as an advocate for the country that appointed him.

72. Paragraph 8 of the sample agreement provides that the appointment of the arbitrators may be postponed where both competent authorities agree that the failure to reach a mutual agreement within the two-year period is mainly attributable to the lack of cooperation by a person directly affected by the case. In that case, the competent authorities may postpone the appointment of the arbitrators by a period of time corresponding to the undue delay in providing them with the relevant information. If that information has not yet been provided when the request for arbitration is submitted, the period of time corresponding to the delay in providing the information continues to run until such information is finally provided. Where, however, the competent authorities are not provided with the information necessary to solve a particular case, there is nothing that prevents them from resolving the case on the basis of the limited information that is at their disposal, thereby preventing any access to arbitration.

Communication of information and confidentiality

73. It is important that arbitrators be allowed full access to the information needed to resolve the issues submitted to arbitration but, at the same time, be subjected to the same strict confidentiality requirements as regards that information as apply to the competent authorities themselves. The proposed approach to ensure that result, which is incorporated in paragraph 7 of the sample agreement, is to make the arbitrators authorised representatives of the competent authorities. This, however, will only be for the purposes of the application of the relevant provisions of the Convention (i.e. Articles 25 and 26) and of the provisions of the domestic laws of the Contracting States, which would normally include the sanctions applicable in case of a breach of confidentiality. The designation of the arbitrator as authorised representative of a competent authority would typically be confirmed in the letter of appointment but may need to be done differently if domestic law requires otherwise or if the arbitrator is not appointed by a competent authority.

Procedural and evidentiary rules

74. The simplest way to establish the evidentiary and other procedural rules that will govern the arbitration process and that have not already been provided in the agreement or the Terms of Reference is to leave it to the arbitrators to develop these rules on an ad hoc basis. In doing so, the arbitrators are free to refer to existing arbitration procedures, such as the International Chamber of Commerce Rules which deal with many of these questions.

75. Paragraph 9 of the sample agreement follows that approach. Thus, decisions as regards the dates and format of arbitration meetings will be made by the arbitrators unless the agreement or Terms of Reference provide otherwise.

Taxpayer participation in the supplementary dispute resolution process

76. Whilst the mutual agreement procedure involves a government-to-government relation, when the process moves to arbitration, the person who presented the case is more of a direct participant. This is especially the case since the arbitration decision will be binding on each State as regards the taxation of that person. Thus, it seems appropriate that the person be able to participate to some degree directly in the arbitration process, though the process would remain under the control of the competent authorities. Paragraph 10 of the sample agreement therefore provides that that person, either directly or through his representatives, is entitled to present a written submission to the arbitrators and, if they all agree, orally during a meeting of the arbitrators. As with other procedural rules, the competent authorities may, however, provide otherwise through the Terms of Reference; they may, for example, define the circumstances and the manner in which taxpayers will participate in the proceedings.

Practical arrangements

77. A number of practical arrangements will need to be made in connection with the actual functioning of the arbitral procedure. They include the location of the meetings, the language of the proceedings and possible translation facilities, the keeping of a record, dealing with practical details such as filing etc.

78. As regards the location and the logistical arrangements for the arbitral meetings, the easiest solution is to leave the matter to be dealt with by the competent authority to which the case giving rise to the arbitration was initially presented. That competent authority should also provide the administrative personnel necessary for the conduct of the arbitration procedure. This

is the approach put forward in paragraph 11 of the sample agreement. It is expected that, for these purposes, the competent authority will use meeting facilities and personnel that it already has at its disposal. The two competent authorities are, however, entitled to agree otherwise (e.g. to take advantage of another meeting in a different location that would be attended by both competent authorities and the arbitrators).

79. It is provided that the administrative personnel provided for the conduct of the arbitration procedure will report only to the Chair of the arbitration panel concerning any matter related to that procedure.

80. The language of the proceedings and whether, and which, translation facilities should be provided is a matter that should normally be dealt with in the Terms of Reference. It may be, however, that a need for translation or recording will only arise after the beginning of the proceedings. In that case, the competent authorities are entitled to reach agreement for that purpose. In the absence of such agreement, the arbitrators could, at the request of one competent authority and pursuant to paragraph 9 of the sample agreement, decide to provide such translation or recording; in that case, however, the costs thereof would have to be borne by the requesting party (see under "Costs" below).

81. Other practical details (e.g. notice and filing of documents) should be similarly dealt with. Thus, any such matter should be decided by agreement between the competent authorities (ideally, included in the Terms of Reference) and, failing such agreement, by decision of the arbitrators.

Costs

82. Different costs may arise in relation to the arbitration process and it should be clear who should bear these costs. Paragraph 12 of the sample agreement, which deals with this issue, is based on the principle that where a competent authority or a person involved in the case can control the amount of a particular cost, this cost should be borne by that party and that other costs should be borne equally by the two competent authorities.

83. Thus, it seems logical to provide that each competent authority, as well as the person who requested the arbitration, should pay for its own participation in the arbitration proceedings. This would include costs of being represented at the meetings and of preparing and presenting a position and arguments, whether in writing or orally.

84. The fees to be paid to the arbitrators are likely to be one of the major costs of the arbitration procedure. Each competent authority will bear the remuneration of the arbitrator appointed exclusively by that competent authority (or appointed by the Director of the OECD Centre for Tax Policy and Administration because of the failure of that competent authority to appoint that arbitrator), together with that arbitrator's travel, telecommunication and secretariat costs. If the arbitrator appointed by the competent authority of a Contracting State is an official of that State, there may, however, not be any such fees.

85. The fees and the travel, telecommunication and secretariat costs of the independent arbitrators will, however, be shared equally by the competent authorities. The competent authorities will normally agree to incur these at the time that the arbitrators are appointed and this would typically be confirmed in the letter of appointment. The fees should be large enough to ensure that appropriately qualified experts could be recruited. One possibility would be to use a fee structure similar to that established under the EU Arbitration Convention Code of Conduct.

86. The costs related to the meetings of the arbitral panel to the administrative personnel necessary for the conduct of the arbitration procedure should be borne by the competent authority to which the case giving rise to the arbitration was initially presented, as long as that competent authority is required to arrange such meetings and provide the administrative personnel (see paragraph 11 of the model mutual agreement). In most cases, that competent authority will use meeting facilities and personnel that it already has at its disposal and it would seem inappropriate to try to allocate part of the costs thereof to the other competent authority. Clearly, the reference to "costs related to the meetings" does not include the travel and accommodation costs incurred by the participants; these are dealt with above.

87. The other costs should be borne equally by the two competent authorities as long as they have agreed to incur the relevant expenses. This would include costs related to translation and recording that both competent authorities have agreed to provide. In the absence of such agreement, the party that has requested that particular costs be incurred should pay for these.

88. As indicated in the paragraph, the competent authorities may, however, agree to a different allocation of costs. Such agreement can be included in the Terms of Reference or be made afterwards (e.g. when unforeseen expenses arise).

Applicable legal principles

89. An examination of the issues on which competent authorities have had difficulties reaching an agreement shows that these are typically matters of treaty interpretation or of applying the arm's length principle underlying Article 9 and paragraph 2 of Article 7. As provided in paragraph 13 of the sample agreement, matters of treaty interpretation should be decided by the arbitrators in light of the principles of interpretation incorporated in Articles 31 to 34 of the *Vienna Convention on the Law of Treaties*, having regard to these Commentaries as periodically amended, as explained in paragraphs 28 to 36.1 of the Introduction. Issues related to the application of the arm's length principle should similarly be decided in light of the *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. Since Article 32 of the *Vienna Convention on the Law of Treaties* permits a wide access to supplementary means of interpretation, arbitrators will, in practice, have considerable latitude in determining relevant sources for the interpretation of treaty provisions.

90. In many cases, the application of the provisions of a tax convention depends on issues of domestic law (for example, the definition of immovable property in paragraph 2 of Article 6 depends primarily on the domestic law meaning of that term). As a general rule, it would seem inappropriate to ask arbitrators to make an independent determination of purely domestic legal issues and the description of the issues to be resolved, which will be included in the Terms of Reference, should take this into account. There may be cases, however, where there would be legitimate differences of views on a matter of domestic law and in such cases, the competent authorities may wish to leave that matter to be decided by an arbitrator who is an expert in the relevant area.

91. Also, there may be cases where the competent authorities agree that the interpretation or application of provision of a tax treaty depends on a particular document (e.g. a memorandum of understanding or mutual agreement concluded after the entry into force of a treaty) but may disagree about the interpretation of that document. In such a case, the competent authorities may wish to make express reference to that document in the Terms of Reference.

Arbitration decision

92. Paragraph 14 of the sample agreement provides that where more than one arbitrator has been appointed, the arbitration decision will be determined by a simple majority of the arbitrators. Unless otherwise provided in the Terms of Reference, the decision is presented in writing and indicates the sources of law relied upon and the reasoning which led to its result. As already indicated, the decision may involve questions of either law or fact, as well as mixed questions of law and fact. Where legal issues are involved, it is important that the arbitrators support their decision with the reasoning leading to it. Showing the method through which the decision was reached is important in assuring acceptance of the decision by all parties.

93. The arbitration decision must be communicated to the competent authorities and the person who made the request for arbitration within six months from the date on which the last of the arbitrators has been appointed. In order to deal with the unusual circumstances in which the arbitrators, for whatever reason, may be unable or unwilling to present an arbitration decision, the paragraph goes on to provide if the decision is not communicated within the relevant period, the competent authorities may agree to either extend the period for presenting the arbitration decision or appoint new arbitrators. In that last case, the arbitration procedure would go back to the point where the original arbitrators were appointed and will continue with the new arbitrators.

Publication of the decision

94. Decisions on individual cases reached under the mutual agreement procedure are generally not made public. In the case of reasoned arbitral decisions, however, publishing the decisions would lend additional transparency to the process. Also, whilst the decision would not be in any sense a binding precedent, having the material in the public domain could influence the course of other cases so as to avoid subsequent disputes and lead to a more uniform approach to the same issue.

95. The last part of paragraph 14 of the sample agreement therefore provides for the possibility to publish the decision. Such publication, however, should only be made if both competent authorities and the person who made the arbitration request so agree. Also, in order to maintain the confidentiality of information communicated to the competent authorities, the publication should be made in a form that would not disclose the names of the parties nor any element that would help to identify them.

Implementing the decision

96. Once the arbitration process has provided a binding solution to the issues that the competent authorities have been unable to resolve, it should be easy for the competent authorities to reach an agreement on how to solve the case presented to them. In order to avoid further delays, it is suggested that the mutual agreement that incorporates the solution arrived at should be completed and implemented as regards the taxation of the taxpayers directly affected by the case within six months from the date of the communication of the decision to the competent authorities. This is provided in paragraph 16 of the sample agreement.

97. Since the arbitration decision is binding on both Contracting States, failure to implement that decision would result in taxation not in accordance with the Convention and, as such, would allow the person whose taxation is affected to seek relief through domestic legal remedies or by making a new request pursuant to paragraph 1 of the Article.

98. Paragraph 17 of the sample agreement deals with the case where the competent authorities are able to solve the unresolved issues that led to arbitration before the decision is rendered. Since the arbitration process is an exceptional mechanism to deal with issues that cannot be solved under the mutual agreement procedure, it is appropriate to put an end to that exceptional mechanism if the competent authorities are able to resolve these issues by themselves. The competent authorities may agree on a resolution of these issues as long as the arbitration decision has not been rendered.

Use of other supplementary dispute resolution mechanisms

99. Regardless of whether or not paragraph 5 is included in a Convention or an arbitration process is otherwise implemented using the procedure described in paragraph 48 above, it is clear that supplementary dispute resolution mechanisms other than arbitration can be implemented on an ad hoc basis as part of the mutual agreement procedure. Where there is disagreement about the relative merits of the positions of the two competent authorities, the case may be helped if the issues are clarified by a mediator. If the issue is a purely factual one, the case could be referred to an expert whose mandate would simply be to make the required factual determinations. Where consistent with domestic law and policy, competent authorities should consider using such mechanisms to avoid that cases presented to them pursuant to Article 25 remain unresolved."

B. Other proposed changes to the Commentary on Article 25 of the OECD Model Tax Convention

16. The 2004 Progress Report recognised the possibility that changes to the Model Tax Convention Commentaries may have a role in enhancing the effectiveness of the Mutual Agreement Procedure ("MAP"). This is reflected in many of the Progress Report's proposals (which are listed at Annex 1). This section addresses the relevant proposals and includes the draft changes to the Commentary on Article 25 that the JWG has drafted to deal with each of them. The numbering of the proposals included in this section refers to the numbering of the relevant proposals of the 2004 Progress Report, and only those proposals leading to suggested Commentary changes are dealt with in this part of this note. Unless otherwise noted, these were listed as proposals for "Future Work" in that Report. In the proposed changes below, the amendments to the existing Commentary are identified by ***bold italics*** for additions and ~~strikethrough~~ for deletions.

Proposal 2: Time limitations

JWG Proposal: *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.*

17. 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. The 2004 Progress Report indicated that there would be benefits in further elaboration as to when this time period begins to run, and therefore finishes.

18. The areas of uncertainty that have been identified are:

- What point represents the "notification" in a self-assessment environment?
- Upon what event should the time period normally be considered to start?
- 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?
- Whether the MAP period should run during the domestic proceeding undertaken before the MAP request is filed (treating MAP time periods for initiation as running during domestic proceedings may result in a taxpayer's inadvertently losing his access to MAP)?
- How to deal with cases where the taxpayer is within time to take the necessary action but where the length of time during which records must be kept under domestic law has expired?

Proposed changes to the Commentary

19. The following are the proposed changes to the Commentary that the JWG has drafted to deal with these issues:

Replace paragraph 18 of the Commentary on Article 25 by the following:

18. The provision fixing the starting point of the three-year time limit as the date of the "first notification of the action resulting in taxation not in accordance with the provisions of the Convention" should be interpreted in the way most favourable to the taxpayer. Thus, even if such taxation should be directly charged in pursuance of an administrative decision or action of general application, the time limit begins to run only from the date of the notification of the individual action giving rise to such taxation, that is to say, under the most favourable interpretation, from the act of taxation itself, as evidenced by a notice of assessment or an official demand or other instrument for the collection or levy of tax. *[the rest of the existing paragraph becomes part of the new paragraph 18.3]****Since a taxpayer has the right to present a case as soon as the taxpayer considers that taxation will result in taxation not in accordance with the provisions of the Convention, while the three-year limit only begins when that result has materialised, there will be cases where the taxpayer will have the right to initiate the mutual agreement procedure before the three-year time limit begins (see the example of such a situation given in paragraph 12 above)***.

18.1 In most cases it will be clear what constitutes the relevant notice of assessment, official demand or other instrument for the collection or levy of tax, and there will usually be domestic law rules governing when that notice is regarded as "given". Such domestic law will usually look to the time when the notice is sent (time of sending), a specific number of days after it is sent, the time when it would be expected to arrive at the address it is sent to (both of which are times of presumptive physical receipt), or the time when it is in fact physically received (time of actual physical receipt). Where there are no such rules, either the time of actual physical receipt or, where this is not sufficiently evidenced, the time when the notice would normally be expected to have arrived at the relevant address should usually be treated as the time of notification, bearing in mind that this provision should be interpreted in the way most favourable to the taxpayer.

18.2 In self assessment cases, there will usually be some notification effecting that assessment (such as a notice of a liability or of a refund), and generally the time of notification, rather than the time when the taxpayer lodges the self-assessed return, would be a starting point for the three year period to run. There may, however, be cases where there is no notice of a liability or the like. In such cases, the relevant time of "notification" would be the time when the taxpayer would, in the normal course of events, be regarded as having been made aware of the taxation that is in fact not in accordance with the treaty. This could, for example, be when information recording the transfer of funds is first made available to a taxpayer, such as in a bank balance or statement. The time begins to run whether or not the taxpayer regards the taxation, at that stage, as contrary to the Convention; notification of the fact of taxation to the taxpayer is enough.

18.3 If the tax is levied by deduction at the source, the time limit begins to run from the moment when the income is paid; however, if the taxpayer proves that only at a later date did he know that the deduction had been made, the time limit will begin from that date. ~~Furthermore, w~~***W***here it is the combination of decisions or actions taken in both Contracting States ~~resulting~~ ***that results*** in taxation not in accordance with the Convention, ~~it~~ ***the time limit*** begins to run only from the first notification of the most recent decision or action. ***This means that where, for example, a Contracting State levies a tax that is not in accordance with the Convention but the other State provides relief for such tax pursuant to Article 23 A or Article 23 B so that there is no double taxation, a taxpayer***

will in practice often not initiate the mutual agreement procedure in relation to the action of the first State. If, however, the other State subsequently notifies the taxpayer that the relief is denied so that double taxation now arises, a new time limit begins from that notification, since the combined actions of both States then result in the taxpayer's being subjected to double taxation contrary to the provisions of the Convention. In some cases, especially of this type, the records held by taxing authorities may have been routinely destroyed before the period of the time limit ends, in accordance with the normal practice of one or both of the States. The Convention obligations do not prevent such destruction, or require a competent authority to accept the taxpayer's arguments without proof, but in such cases the taxpayer should be given the opportunity to supply the evidential deficiency, as the mutual agreement procedure continues, to the extent domestic law allows. In some cases, the other Contracting State may be able to provide sufficient evidence, in accordance with Article 26 of the Model Tax Convention. It is, of course, preferable that such records be retained by tax authorities for the full period during which a taxpayer is able to seek to initiate the mutual agreement procedure in relation to a particular matter.

18.4 The three-year period continues to run during any domestic law (including administrative) proceedings (e.g. a domestic appeal process). This could create difficulties by in effect requiring a taxpayer to choose between domestic law and mutual agreement procedure remedies. Some taxpayers may rely solely on the mutual agreement procedure, but many taxpayers will attempt to address these difficulties by initiating a mutual agreement procedure while simultaneously initiating domestic law action, even though the domestic law process is initially not actively pursued. This could result in mutual agreement procedure resources being inefficiently applied. Where domestic law allows, some States may wish to specifically deal with this issue by allowing for the three-year (or longer) period to be suspended during the course of domestic law proceedings. Two approaches, each of which is consistent with Article 25 are, on one hand, requiring the taxpayer to initiate the mutual agreement procedure, with no suspension during domestic proceedings, but with the competent authorities not entering into talks in earnest until the domestic law action is finally determined, or else, on the other hand, having the competent authorities enter into talks, but without finally settling an agreement unless and until the taxpayer agrees to withdraw domestic law actions. This second possibility is discussed at paragraph 31 of this Commentary. In either of these cases, the taxpayer should be made aware that the relevant approach is being taken. Whether or not a taxpayer considers that there is a need to lodge a "protective" appeal under domestic law (because, for example, of domestic limitation requirements for instituting domestic law actions) the preferred approach for all parties is often that the mutual agreement procedure should be the initial focus for resolving the taxpayer's issues, and for doing so on a bilateral basis.

Proposal 3: Probability of taxation not in accordance with the Convention

JWG proposal: *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.*

20. As noted by paragraph 12 of the OECD Model Tax Convention Commentary on Article 25, to set the taxpayer-initiated MAP action in progress the taxpayer need 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. 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.

21. 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 the example at paragraph 20 of the Progress Report of a withholding tax payment on which a foreign tax credit is later denied).

22. 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.

Proposed changes to the Commentary

23. The following are the proposed changes to the Commentary that the JWG has drafted to deal with these issues:

> *Replace paragraph 12 of the Commentary on Article 25 by the following:*
>
> 12. It should be noted that the mutual agreement procedure, unlike the disputed claims procedure under domestic law, can be set in motion by a taxpayer without waiting until the taxation considered by him to be "not in accordance with the Convention" has been charged against or notified to him. To be able to set the procedure in motion, he must, and it is sufficient if he does, establish that the "actions of one or both of the Contracting States" will result in such taxation, and that this taxation appears as a risk which is not merely possible but probable. Such actions mean all acts or decisions, whether of a legislative or a regulatory nature, and whether of general or individual application, having as their direct and necessary consequence the charging of tax against the complainant contrary to the provisions of the Convention. ***Thus, for example, if a change to a Contracting State's tax law would result in a person deriving a particular type of income being subjected to taxation not in accordance with the Convention, that person could set the mutual agreement procedure in motion as soon as the law has been amended and that person has derived the relevant income or it becomes probable that the person will derive that income. As indicated by the opening words of paragraph 1, whether or not the actions of one or both of the Contracting States will result in taxation not in accordance with the Convention must be determined from the perspective of the taxpayer. Whilst the taxpayer's belief that there will be such taxation must be reasonable and must be based on facts that can be established, the tax authorities should not refuse to consider a request under paragraph 1 merely because they consider that it has not been proven (for example to domestic law standards of proof on the "balance of probabilities") that such taxation will occur.***

Proposal 4: Denial of access to the MAP

JWG proposal: *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.*

24. 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.

Proposed changes to the Commentary

25. The following are the proposed changes to the Commentary that the JWG has drafted to deal with these issues:

Add the following paragraphs immediately after paragraph 18.4, as amended in accordance with Proposal 2 above, as follows:

18.5 Some States may deny the taxpayer the ability to initiate the mutual agreement procedure under paragraph 1 of Article 25 in cases where the transactions to which the request relates are regarded as abusive. This issue is closely related to the issue of "improper use of the Convention" discussed in paragraph 9.1 and following of the Commentary on Article 1. In the absence of a special provision, there is no general rule denying perceived abusive situations going to the mutual agreement procedure, however. While some States may wish to add a special requirement that taxpayers may not initiate the mutual agreement procedure when there is some feature such as that certain types of penalties have been imposed on the taxpayer, that requirement should be made clear in the Convention unless such penalties would only be imposed where there was a determination that abuse had occurred, and where the abuse evidenced by the imposition of such penalties would be such as to deny the benefits of the Convention in any case. In those cases, a reference to the penalties is, in effect, merely a short-hand way of defining abusive situations, consistent with the terms of the Convention.

18.6 Some States regard certain issues as not susceptible to resolution by the mutual agreement procedure generally, or at least by taxpayer-initiated mutual agreement procedure, because of constitutional or other domestic law provisions or decisions. An example would be a case where granting the taxpayer relief would be contrary to a final court decision that the tax authority is required to adhere to under that State's constitution. The recognised general principle for tax and other treaties is that domestic law, even domestic constitutional law, does not justify a failure to meet treaty obligations, however. Article 27 of the Vienna Convention on the Law of Treaties reflects this general principle of treaty law. It follows that any justification for what would otherwise be a breach of the Convention needs to be found in the terms of the Convention itself, as interpreted in accordance with accepted tax treaty interpretation principles. Such a justification would be rare, because it would not merely govern how a matter will be dealt with by the two States once the matter is within the mutual agreement procedure, but would instead prevent the matter from even reaching the stage when it is considered by both States. Since such a determination might in practice be reached by one of the States without consultation with the other, and since there might be a bilateral solution that therefore remains unconsidered, the view that a matter is not susceptible of taxpayer-initiated mutual agreement procedure should not be lightly made, and needs to be supported by the terms of the Convention as negotiated. A competent authority relying upon a domestic law impediment as the reason for not allowing the mutual agreement procedure to be initiated by a taxpayer should inform the other competent authority of this and duly explain the legal basis of its position. More usually, genuine domestic law impediments will not prevent a matter from entering into the mutual agreement procedure, but if they will clearly and unequivocally prevent a competent authority from resolving the issue in a way that avoids taxation of the taxpayer which is not in accordance with the Convention, and there is no realistic chance of

the other State resolving the issue for the taxpayer, then that situation should be made public to taxpayers, so that taxpayers do not have false expectations as to the likely outcomes of the process.

18.7 In other cases, initiation of the mutual agreement procedure may have been allowed but domestic law issues that have arisen since the negotiation of the treaty may prevent a competent authority from resolving, even in part, the issue raised by the taxpayer. Where such developments have a legally constraining effect on the competent authority, so that bilateral discussions can clearly not resolve the matter, most States would accept that this change of circumstances is of such significance as to allow that competent authority to withdraw from the procedure. In some cases, the difficulty may be only temporary however; such as while rectifying legislation is enacted, and in that case, the procedure should be suspended rather than terminated. The two competent authorities will need to discuss the difficulty and its possible effect on the mutual agreement process. There will also be situations where a decision wholly or partially in the taxpayer's favour is binding and must be followed by one of the competent authorities but where there is still scope for mutual agreement discussions, such as for example in one competent authority's demonstrating to the other that the latter should provide relief.

18.8 There is less justification for relying on domestic law for not implementing an agreement reached as part of the mutual agreement procedure. The obligation of implementing such agreements is unequivocally stated in the last sentence of paragraph 2, and impediments to implementation that were already existing should generally be built into the terms of the agreement itself. As tax conventions are negotiated against a background of a changing body of domestic law that is sometimes difficult to predict, and as both parties are aware of this in negotiating the original Convention and in reaching mutual agreements, subsequent unexpected changes that alter the fundamental basis of a mutual agreement would generally be considered as requiring revision of the agreement to the extent necessary. Obviously where there is a domestic law development of this type, something that should only rarely occur, good faith obligations require that it be notified as soon as possible, and there should be a good faith effort to seek a revised or new mutual agreement, to the extent the domestic law development allows. In these cases, the taxpayer's request should be regarded as still operative, rather than a new application's being required from that person.

Proposal 6: Suspension of collection of tax

JWG proposal: *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.*

26. 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.

27. It is recognised 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.

Proposed changes to the Commentary

28. The following are the proposed changes to the Commentary that the JWG has drafted to deal with these issues:

Add the following paragraphs:

31.3 Some States take the view that a mutual agreement procedure may not be initiated by a taxpayer unless and until payment of all or a specified portion of the tax amount in dispute has been made. They consider that the requirement for payment of outstanding taxes, subject to repayment in whole or in part depending on the outcome of the procedure, is an essentially procedural matter not governed by Article 25, and is therefore consistent with it. A contrary view, held by many States, is that Article 25 indicates all that a taxpayer must do before the procedure is initiated, and that it imposes no such requirement. Those States find support for their view in the fact that the procedure may be implemented even before the taxpayer has been charged to tax or notified of a liability (as noted at paragraph 12 above) and in the acceptance that there is clearly no such requirement for a procedure initiated by a competent authority under paragraph 3.

31.4 Article 25 gives no absolutely clear answer as to whether a taxpayer-initiated mutual agreement procedure may be denied on the basis that there has not been the necessary payment of all or part of the tax in dispute. However, whatever view is taken on this point, in the implementation of the Article it should be recognised that the mutual agreement procedure supports the substantive provisions of the Convention and that the text of Article 25 should therefore be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance. States therefore should as far as possible take into account the cash flow and possible double taxation issues in requiring advance payment of an amount that the taxpayer contends was at least in part levied contrary to the terms of the relevant Convention. As a minimum, payment of outstanding tax should not be a requirement to initiate the mutual agreement procedure if it is not a requirement before initiating domestic law review. It also appears, as a minimum, that if the mutual agreement procedure is initiated prior to the taxpayer's being charged to tax (such as by an assessment), a payment should only be required once that charge to tax has occurred.

31.5 Where States take the view that payment of outstanding tax is a precondition to the taxpayer-initiated mutual agreement procedure, this should be notified to the treaty partner during negotiations on the terms of a Convention. Where both States party to a Convention take this view, there is a common understanding, but also the particular risk of the taxpayer's being required to pay an amount twice. Where domestic law allows it, one possibility which States might consider to deal with this would be for the higher of the two amounts to be held in trust, escrow or similar, pending the outcome of the mutual agreement procedure. Alternatively, a bank guarantee provided by the taxpayer's bank could be sufficient to meet the requirements of the competent authorities. As another approach, one State or the other (decided by time of assessment, for example, or by residence State status under the treaty) could agree to seek a payment of no more than the difference between the amount paid to the other State, and that which it claims, if any. Which of these possibilities is open will ultimately depend on the domestic law (including administrative requirements) of a particular State, but they are the sorts of options that should as far as possible be considered in seeking to have the mutual agreement procedure operate as effectively as possible. Where States require some payment of outstanding tax as a precondition to the taxpayer-initiated

mutual agreement procedure, or to the active consideration of an issue within that procedure, they should have a system in place for refunding an amount of interest on any underlying amount to be returned to the taxpayer as the result of a mutual agreement reached by the competent authorities. Any such interest payment should sufficiently reflect the value of the underlying amount and the period of time during which that amount has been unavailable to the taxpayer.

Proposal 7: Suspension or remission of interest and penalties

JWG proposal: *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.*

29. This issue relates in some ways to the suspension of tax collection issue, but has 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.

30. Another related 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.

Proposed changes to the Commentary

31. The following are the proposed changes to the Commentary that the JWG has drafted to deal with these issues:

Add the following paragraph:

31.6 States take differing views as to whether administrative interest and penalty charges are treated as taxes covered by Article 2 of the Convention. Some States treat them as taking the character of the underlying amount in dispute, but other States do not. It follows that there will be different views as to whether such interest and penalties are subject to a taxpayer-initiated mutual agreement procedure. Where they are covered by the Convention as taxes to which it applies, the object of the Convention in avoiding double taxation, and the requirement for States to implement conventions in good faith, suggest that as far as possible interest and penalty payments should not be imposed in a way that effectively discourages taxpayers from initiating a mutual agreement procedure, because of the cost and the cash flow impact that this would involve. Even when administrative interest and penalties are not regarded as taxes covered by the Convention under Article 2, they should not be applied in a way that severely discourages or nullifies taxpayer reliance upon the benefits of the Convention, including the right to initiate the mutual agreement procedure as provided by Article 25. As a minimum, a State's requirements as to payment of outstanding penalties and interest should not be more onerous to taxpayers in the context of the mutual agreement procedure than they would be in the context of taxpayer-initiated domestic law review.

Proposal 9: MAP and corresponding adjustments

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

32. 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."

33. Despite the discussion at paragraphs 8-10 of the Commentary on Article 25, there have 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.

Proposed changes to the Commentary

34. The following are the proposed changes to the Commentary that the JWG has drafted to deal with these issues:

> *Replace paragraph 10 of the Commentary on Article 25 by the following:*
>
> 10. This in fact is implicit in the wording of paragraph 2 of Article 9 when the bilateral convention in question contains a clause of this type. When the bilateral convention does not contain rules similar to those of paragraph 2 of Article 9 (as is usually the case for conventions signed before 1977) the mere fact that Contracting States inserted in the convention the text of Article 9, as limited to the text of paragraph 1 — which usually only confirms broadly similar rules existing in domestic laws — indicates that the intention was to have economic double taxation covered by the Convention. As a result, most 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. *[the rest of the existing paragraph becomes the last sentence of paragraph 10.1]*
>
> ***10.1 While the mutual agreement procedure has a clear role in dealing with issues arising as to the sorts of adjustments referred to in paragraph 2 of Article 9, it follows that even in the absence of such a provision, States should be seeking to avoid double taxation, including by giving corresponding adjustments in cases of the type contemplated in paragraph 2. While there may be some difference of view, States would therefore generally regard a taxpayer-initiated mutual agreement procedure based upon economic double taxation contrary to the terms of Article 9 as encompassing issues of whether a corresponding adjustment should have been provided, even in the absence of a provision similar to paragraph 2 of Article 9.*** 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.

Proposal 11: Relationship between domestic law and the MAP process

JWG proposal: *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.*

35. Possible domestic law limitations on taxpayers initiating the mutual agreement process have already been noted (see Proposal 4 above). Other domestic law constraints may not prevent initiation of the process but may prevent an agreement's 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 on 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 of the first State considers that there is no legal authority to agree to a different interpretation under the MAP procedure.

36. 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 could not be implemented under their domestic law.

Proposed changes to the Commentary

37. The following are the proposed changes to the Commentary that the JWG has drafted to deal with these issues:

Replace paragraph 31 by the following:

31. ~~Finally, t~~The case may arise where a mutual agreement is concluded in relation to a taxpayer who has brought a suit for the same purpose in the competent court of either Contracting State and such suit is still pending. In such a case, there would be no grounds for rejecting a request by a taxpayer that he be allowed to defer acceptance of the solution agreed upon as a result of the mutual agreement procedure until the court had delivered its judgment in th***at*** suit ~~still pending~~. *[the rest of the existing paragraph becomes the last part of paragraph 31.2, with some modifications]* ***Also, a view that competent authorities might reasonably take is that where the taxpayer's suit is ongoing as to the particular issue upon which mutual agreement is sought by that same taxpayer, discussions of any depth at the competent authority level should await a court decision. If the taxpayer's request for a mutual agreement procedure applied to different tax years than the court action, but to essentially the same factual and legal issues, so that the court outcome would in practice be expected to affect the treatment of the taxpayer in years not specifically the subject of litigation, the position might be the same, in practice, as for the cases just mentioned. Of course, if competent authorities consider, in either case, that the matter might be resolved notwithstanding the domestic law proceedings (because, for example, the competent authority where the court action is taken will not be bound or constrained by the court decision) then the mutual agreement procedure may proceed as normal.***

31.1 The situation is also different if there is a suit ongoing on an issue, but the suit has been taken by another taxpayer than the one who is seeking to initiate the mutual agreement procedure. In principle, if the case of the taxpayer seeking the mutual agreement procedure supports action by one or both competent authorities to prevent taxation not in accordance with the Convention, that should not be unduly delayed pending a general clarification of the law at the instance of another taxpayer - although the taxpayer seeking mutual agreement might agree to this if the clarification is likely to favour that taxpayer's case. In other cases, delaying competent authority discussions as part of a mutual agreement procedure may be justified in all the circumstances, but the competent authorities should as far as possible seek to prevent disadvantage to the taxpayer seeking mutual agreement in such a case. This could be done, where domestic law allows, by deferring payment of the amount outstanding during the course of the delay, or at least during that part of the delay which is beyond the taxpayer's control.

31.2 As noted above, there may be a pending suit by the taxpayer on an issue, or else the taxpayer may have preserved the right to take such domestic law action, yet the competent authorities might still consider that an agreement can be reached. In such cases, it is, however, ~~On the other hand, it is~~ necessary to take into account the concern of ~~the~~ ***a particular*** competent authority to avoid any divergence***s*** or contradiction***s*** between the decision of the court and the mutual agreement ***that is being sought***, with the difficulties or risks of abuse that the~~y~~***se*** could entail. In short, therefore, ~~it seems normal that~~ the implementation of ***such*** a mutual agreement should ***normally*** be made subject:

— to the acceptance of such mutual agreement by the taxpayer, and
— to the taxpayer's withdrawal of ~~his~~ ***the*** suit at law concerning ~~the~~ ***those*** points settled in the mutual agreement.

Progress Report Proposal 6 for "Future Study": Scope of paragraph 3 of Article 25

JWG proposal: *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 problems*

38. This item was Proposal 6 for "Future Study" in the 2004 Progress Report. 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." The general view seems to be that the design of paragraph 3, first sentence, is directed towards 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, of course, prevent MAP from being initiated on an issue arising in a particular case, or prevent a competent authority from seeking a result that is in fact beneficial to a particular taxpayer. Paragraph 3 emphasises the facilitative aspect of MAP, which contributes to ensuring the continuing relevance of tax treaties designed to last for a considerable period of time.

39. The second sentence of paragraph 3 is more directly aimed at particular cases but is also clearly the language of facilitation or authorisation 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 on Article 25). The provision gives great flexibility as to how the consultations occur.

40. The second sentence also does not by its terms afford taxpayers the same right of initiation as under paragraph 1 for matters relating to the Convention, yet it also does not prevent competent authorities from together allowing such rights. In practical terms, a competent authority 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 competent authority to institute MAP.

41. 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.

42. Since such 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, instead, under paragraph 3. Indeed, paragraph 37 of the Commentary on Article 25 notes that the second sentence of paragraph 3 of Article 25 might be used to help disputes in the PE context described above, and encourages its use to avoid double taxation. However, paragraph 37 goes on to point out some problems for some Contracting States in applying this paragraph – States where domestic law prevents the treaty from being "complemented on points which are not explicitly or at least implicitly dealt with". Also a number of States do not include the second sentence of paragraph 3 in their bilateral treaties for this or other reasons.

43. The 2004 Progress Report noted these issues and considered that it would thus be appropriate to re-examine paragraph 3 of the Article to make sure that it is more widely available for use in appropriate cases.

Proposed changes to the Commentary

44. The following are the proposed changes to the Commentary that the JWG has drafted to deal with these issues:

Replace paragraph 37 by the following:

37. The second sentence of paragraph 3 enables the competent authorities to deal also with such cases of double taxation as do not come within the scope of the provisions of the Convention. Of special interest in this connection is the case of a resident of a third State having permanent establishments in both Contracting States. It is ~~of course~~ ***not merely*** desirable***, but in most cases also will particularly reflect the role of Article 25 and the mutual agreement procedure in providing that the competent authorities may consult together as a way of ensuring the Convention as a whole operates effectively,*** that the mutual agreement procedure should result in the effective elimination of the double taxation which can occur in such a situation. ***The opportunity for such matters to be dealt with under the mutual agreement procedure becomes increasingly important as Contracting States seek more coherent frameworks for issues of profit allocation involving branches, and this is an issue that could usefully be discussed at the time of negotiating conventions or protocols to them. There will be*** ~~An exception must, however, be made for the case of~~ Contracting States whose domestic law prevents the Convention from being complemented on points which are not explicitly or at least implicitly dealt with~~,~~ ***in the Convention, however, and*** ~~in such a case~~ ***in these situations*** the Convention could be complemented ~~only~~ by a protocol ~~subject, like the Convention itself, to ratification or approval~~ ***dealing with this issue***. ***In most cases, however, the terms of the Convention itself, as interpreted in accordance with accepted tax treaty interpretation principles, will sufficiently support issues involving two branches of a third state entity being subject to the paragraph 3 procedures.***

C. Manual on Effective Mutual Agreement Procedure

45. The 2004 Progress Report also included a proposal for a Manual on Effective Mutual Agreement ("MEMAP") to explain the various stages of the mutual agreement procedure, discuss various issues related to that procedure and, where appropriate, describe best practices. The MEMAP is currently being developed and will take the form of a website available to taxpayers and tax administrations alike. A preliminary version of the MEMAP website will be launched at or before the time of the Tokyo public consultation on 13 March 2006. The preliminary version of the MEMAP website will be accessible to the public from the main OECD website, and comments on the preliminary version of the site should be sent in electronic form by 30 June 2006. It is intended that the MEMAP website will be operational in final form by early 2007.

D. Conclusions on other proposals included in the 2004 Progress Report

46. The following are other proposals included in the 2004 Progress Report and the conclusions that the JWG has reached on how to deal with each of them. The numbering is that in the progress report, under the heading of "Proposals for Future Study". Proposal 6 under that heading is dealt with in section B above.

Proposal 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."*

47. The JWG agreed that a periodical analysis of MAP cases could be useful, and asked that the Secretariat provide a simple proposal for reporting.

Proposal 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."*

48. The JWG considered that there was the possibility that work in this area at this stage and in the context of the other MAP work could be seen as endorsing approaches that only provide partial relief of double taxation. For that reason, it was agreed not to pursue that proposal for the time being.

Proposal 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."*

49. While the JWG saw this as an area for possible OECD work in future, it did not believe it was in a position to provide particular guidance at this stage and considered that this subject matter would be better addressed by the OECD Committee on Fiscal Affairs' Working Party No. 6 on the Taxation of Multinational Enterprises. The Secretariat will draft a note to Working Party No. 6.

Proposal 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."*

50. This issue concerns adjustments on "secondary transactions", by which some States proposing a transfer pricing adjustment provide under their domestic law for a constructive transaction whereby the excess profits resulting from a primary adjustment are treated as having been transferred in a particular form (such as constructive dividends, equity contributions or loans) and are taxed accordingly.

51. The JWG agreed that the issue of secondary adjustments was an important one on which work should be carried out. It was agreed that this issue would be brought to the attention of the OECD Committee on Fiscal Affairs' Working Party No. 1 on Tax Conventions and Related Questions and Working Party No. 6, as appropriate.

Proposal 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."*

52. The JWG concluded that this was a matter of substance, related to the broader issue of the application of bilateral treaties in situations involving more than two States. Bearing in mind the work that Working Party No. 1 on Tax Conventions and Related Questions has done on the issue in the past (it produced a report on "Triangular Cases" in 1992) it was agreed that a note would be presented to it on examples of triangular cases and the issues they raised in this area, with a view to that Working Party's consulting with Working Party No. 6 on the Taxation of Multinational Enterprises as appropriate.

ANNEX 1: THE PROPOSALS INCLUDED IN THE 2004 PROGRESS REPORT

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 supplemental 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: TIME LIMITS FOR THE VARIOUS STAGES OF THE ARBITRATION PROCESS

(DEFAULT PROCEDURE)

TIMELINE	WHEN	STAGE
0	Beginning of the process	Presentation of a MAP case to each competent authority
24 months	Not before 2 years after presentation of MAP case to the second competent authority	Presentation by the person who made the MAP request of a request for arbitration of unresolved issues
27 months	Not later than 3 months after presentation of the request for arbitration	Drafting and presentation of the Terms of Reference to the person who made the request
30 months	Not later than 3 months after presentation of the Terms of Reference	Appointment of arbitrators by competent authorities
	Not later than 1 month after previous 3 months	Appointment of arbitrators by other arbitrators in case of failure to do so by competent authorities
	Not later than 10 days after previous month	Appointment of arbitrators by Director of CTPA in case of failure to do so by competent authorities and other arbitrators
36 months	Not later than 6 months after appointment of the last arbitrator	Decision of the arbitrator is communicated to the competent authorities and the person who made the request

TIME LIMITS FOR THE VARIOUS STAGES OF THE ARBITRATION PROCESS

(STREAMLINED PROCEDURE)

TIMELINE	WHEN	STAGE
0	Beginning of the process	Presentation of a MAP case to each competent authority
24 months	Not before 2 years after presentation of MAP case to the second competent authority	Presentation by the person who made the MAP request of a request for arbitration of unresolved issues
27 months	Not later than 3 months after presentation of the request for arbitration	Drafting and presentation of the Terms of Reference to the person who made the request
28 months	Not later than 1 month after presentation of the Terms of Reference	Appointment of arbitrators by competent authorities
	Not later than 10 days after previous month	Appointment of arbitrator by Director of CTPA in case of failure to do so by competent authorities
30 months	Not later than 2 months after appointment of the arbitrator	Written presentation of positions of each competent authority
31 months	Not later than 1 month after presentation of the positions	Decision of the arbitrator is communicated to the competent authorities