ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

IMPROVING THE RESOLUTION OF TAX TREATY DISPUTES

(Report adopted by the Committee on Fiscal Affairs on 30 January 2007)

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CENTRE FOR TAX POLICY AND ADMINISTRATION

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IMPROVING 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 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 procedure" for both OECD and non-OECD countries.[2]

3. Other proposals required additional work. The note entitled "Proposals for Improving Mechanisms for the Resolution of Tax Treaty Disputes", which was released as a public discussion draft (the "Public Discussion Draft") on 1 February 2006, provided the results of that follow-up work. It included various draft changes to the OECD Model Tax Convention, dealing primarily with the addition of an arbitration process to solve disagreements arising in the course of a mutual agreement procedure, as well as a proposal for developing an online Manual on Effective Mutual Agreement Procedure.

4. A number of written comments were received on the Public Discussion Draft. Also, a public consultation meeting, attended by over 150 participants, was held in Tokyo on 13 March 2006. As a result of these comments and meeting, a number of modifications have been made to the proposed changes to the OECD Model Tax Convention that were included in the Public Discussion Draft. These changes are reflected in this note, which was approved by the Committee on Fiscal Affairs on 30 January 2007.

5. Section A of this note includes the revised version of the proposal to add to the OECD Model Tax Convention an arbitration process to deal with unresolved issues that prevent competent authorities from reaching a mutual agreement. In a number of written comments and during the March 2006 public consultation meeting, the interaction between the proposed arbitration process and domestic legal remedies was a prominent theme. Business participants expressed concern as regards the proposal that domestic legal remedies would have to be waived in order for unresolved issues to be brought to arbitration. In response to these comments, the Committee has changed its proposal and has decided that the person who makes the arbitration request (or any person affected by the case) will not be required to waive rights to domestic remedies as a condition for requesting arbitration. The changes made to the previous version of section A are primarily intended to implement that option.

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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.

6. Section B includes a slightly revised version of the changes to the Commentary on Article 25 that address proposals included in the 2004 Progress Report dealing with various issues that may arise in the course of a mutual agreement procedure.

7. The changes to the Model Tax Convention included in sections A and B will now be included in the next update to the Model, which will be published in 2008.

8. Section C deals with the follow-up to the other proposals of the 2004 Progress Report. It refers to the online Manual on Effective Mutual Agreement Procedure ("MEMAP") that has been developed in response to a number of proposals of the 2004 Progress Report. This manual explains the various stages of the mutual agreement procedure, discusses various issues related to that procedure and, where appropriate, describes best practices. It is available at www.oecd.org/ctp/memap and will be updated periodically to reflect new developments. Section C also includes a reporting framework for MAP cases that the Committee intends to use to collect and make public statistical information on MAP cases.

9. Annex 1 lists all the proposals included in the 2004 Progress Report and, where follow-up work was required, refers to the part of this report that describes how the proposal was subsequently dealt with. Annex 2 includes the reporting framework referred to in section C.

A. ARBITRATION OF UNRESOLVED ISSUES IN A MUTUAL AGREEMENT CASE

10. The existing mutual agreement procedure ("MAP") 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 with the treaty. Since the MAP 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" where the countries cannot agree.

11. The inability of the current MAP 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 tax officials 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.

12. The MAP can thus be improved by supplementing it with additional dispute resolution techniques which can help to resolve issues which have prevented the countries from reaching agreement in a MAP. In this way, 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. The techniques are aimed at ensuring that the competent authorities are able to offer to the taxpayer an agreed solution to the case which he has presented. On the other hand, where the competent authorities are able to resolve their differences as to the application of the treaty without recourse to supplementary techniques, there is no further need for applying such techniques in that case.

13. These additional techniques can make the MAP 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 since both governments and taxpayers will know at the outset that the time and effort put into the MAP will be likely to produce a satisfactory result. Further, governments will have an incentive to ensure that the MAP 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.

14. For these reasons, the 2004 Progress Report indicated that a proposal related to the mandatory resolution of unresolved MAP issues should be developed. As a result of work on that proposal, the Committee has concluded that the additional paragraph below (together with its Commentary and annex thereto) should be added to Article 25 of the OECD Model Tax Convention to provide for the arbitration of unresolved issues that prevent competent authorities from reaching an agreement on a MAP case within 2 years.

Proposed paragraph

15. The following is a revised version of the proposed new paragraph that was included in the Public Discussion Draft of 1 February 2006. The changes to the paragraph mainly reflect the decision not to require a waiver of domestic remedies as a condition for initiating the arbitration process.

Add the following new paragraph 5 to Article 25:

"5. Where,

a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

b) 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 a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that 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 States may only wish to include this paragraph in treaties with certain States. 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 47 of the Commentary on the paragraph. As mentioned in paragraph 54 of that Commentary, however, other States may be able to agree to remove from the paragraph the condition that issues may not be submitted to arbitration if a decision on these issues has already been rendered by one of their courts or administrative tribunals."

Proposed Commentary on the new paragraph

16. The following is a revised version of the Commentary on the new paragraph (other consequential changes to the Commentary will be made when the following paragraphs are included in the Model Tax Convention).

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 69 (and renumber existing paragraphs 49 to 54 as paragraphs 70 to75).

~~"IV. 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 cases where the competent authorities are unable to reach an agreement under paragraph 2 within two years, the unresolved issues will, at the request of the person who presented the case, be solved through an arbitration process. This process is not dependent on a prior authorization by the competent authorities: once the requisite procedural

requirements have been met, the unresolved issues that prevent the conclusion of a mutual agreement must be submitted to arbitration.

46. The arbitration process provided for by the paragraph is not an alternative or additional recourse: where the competent authorities have reached an agreement that does not leave any unresolved issues as regards the application of the Convention, 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 correct 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 on one or more issues that prevent the resolution of a case, a resolution of the case will still be possible by submitting those issues to arbitration. Thus, under the paragraph, the resolution of the *case* continues to be reached through the mutual agreement procedure, whilst the resolution of a particular *issue* which is preventing agreement in the case is handled through an arbitration process. This distinguishes the process established in paragraph 5 from other forms of commercial or government-private party arbitration where the jurisdiction of the arbitral panel extends to resolving the whole case.

47. 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 issues. In addition, some countries may only be in a position to include this paragraph in treaties with particular States. For these reasons, the paragraph should only be included in the Convention where each State concludes that the process is capable of effective implementation.

48. In addition, some States may wish to include paragraph 5 but limit its application to a more restricted range of cases. For example, access to arbitration could be restricted to cases involving issues which are primarily factual in nature. It could also be possible to provide that arbitration would always be available for issues arising in certain classes of cases, for example, highly factual cases such as those related to transfer pricing or the question of the existence of a permanent establishment, whilst extending arbitration to other issues on a case-by-case basis.

49. States which are members of the European Union must co-ordinate the scope of paragraph 5 with their obligations under the European Arbitration Convention.

50. The taxpayer should be able to request arbitration of unresolved issues in all cases dealt with under the mutual agreement procedure that have been presented under paragraph 1 on the basis that the actions of one or both of the Contracting States have resulted for a person in taxation not in accordance with the provisions of this Convention. Where the mutual agreement procedure is not available, for example because of the existence of serious violations involving significant penalties (see paragraph 18.5), it is clear that paragraph 5 is not applicable.

51. 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 the annex, to which they would add the following first paragraph:

> "1. Where,
>
> a) under paragraph 1 of Article 25 of the Convention, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or

both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 of the Article 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 a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, 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 the annex. 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.

52. Paragraph 5 provides that a person who has presented a case to the competent authority of a Contracting State pursuant to paragraph 1 on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention 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 who 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.

53. Under paragraph 2 of Article 25, the competent authorities must endeavour to resolve a case presented under paragraph 1 with a view to the avoidance of taxation not in accordance with the Convention. For the purposes of paragraph 5, a case should therefore not be considered to have been resolved as long as there is at least one issue on which the competent authorities disagree and which, according to one of the competent authorities, indicates that there has been taxation not in accordance with the Convention. One of the competent authorities could not, therefore, unilaterally decide that such a case is closed and that the person involved cannot request the arbitration of unresolved issues; similarly, the two competent authorities could not consider that the case has been resolved and deny the request for arbitration if there are still unresolved issues that prevent them from agreeing that there has not been taxation not in accordance with the Convention. Where, however, the two competent authorities agree that taxation by both States has been in accordance with the Convention, there are no unresolved issues and the case may be considered to have been resolved, even in the case where there might be double taxation that is not addressed by the provisions of the Convention.

54. The arbitration process is only available in cases where the person considers that taxation not in accordance with the provisions of the Convention has actually resulted from the actions of one or both of the Contracting States; it is not available, however, in cases where it is argued that

such taxation will eventually result from such actions even if the latter cases may be presented to the competent authorities under paragraph 1 of the Article (see paragraph 52 above). For that purpose, taxation should be considered to have resulted from the actions of one or both of the Contracting States as soon as, for example, tax has been paid, assessed or otherwise determined or even in cases where the taxpayer is officially notified by the tax authorities that they intend to tax him on a certain element of income.

55. 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. In some cases, a mutual agreement case may arise from other specific treaty provisions, such as subparagraph 2 *b*) of Article 4. Under that subparagraph, the competent authorities are, in certain cases, required to settle by mutual agreement the question of the status of an individual who is a resident of both Contracting States. As indicated in paragraph 20 of the Commentary on Article 4, such cases must be resolved according to the procedure established in Article 25. If the competent authorities fail to reach an agreement on such a case and this results in taxation not in accordance with the Convention (according to which the individual should be a resident of only one State for purposes of the Convention), the taxpayer's case comes under paragraph 1 of Article 25 and, therefore, paragraph 5 is applicable.

56. 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 second sentence of the paragraph.

57. 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 the annex) should specify which type of information will normally be sufficient for that purpose.

58. 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 issues submitted to arbitration have already been resolved through the domestic litigation process of either State (which means that any court or administrative tribunal of one of the Contracting States has already rendered a decision that deals with these issues and that applies to that person). This is consistent with the approach adopted by most countries as regards the mutual agreement procedure and according to which:

a) A person cannot pursue simultaneously the mutual agreement procedure and domestic legal remedies. Where domestic legal remedies are still available, the competent authorities will generally either require that the taxpayer agree to the suspension of these remedies or, if the taxpayer does not agree, will delay the mutual agreement procedure until these remedies are exhausted.

b) Where the mutual agreement procedure is first pursued and a mutual agreement has been reached, the taxpayer and other persons directly affected by the case are offered the possibility to reject the agreement and pursue the domestic remedies that had been suspended; conversely, if these persons prefer to have the agreement apply, they will have to renounce the exercise of domestic legal remedies as regards the issues covered by the agreement.

c) Where the domestic legal remedies are first pursued and are exhausted in a State, a person may only pursue the mutual agreement procedure in order to obtain relief of double taxation in the other State. Indeed, once a legal decision has been rendered in a particular case, most countries consider that it is impossible to override that decision through the mutual agreement procedure and would therefore restrict the subsequent application of the mutual agreement procedure to trying to obtain relief in the other State.

The same general principles should be applicable in the case of a mutual agreement procedure that would involve one or more issues submitted to arbitration. It would not be helpful to submit an issue to arbitration if it is known in advance that one of the countries is limited in the response that it could make to the arbitral decision. This, however, would not be the case if the country could, in a mutual agreement procedure, deviate from a court decision (see paragraph 56) and in that case paragraph 5 could be adjusted accordingly.

59. A second issue involves the relationship between existing domestic legal remedies and arbitration where the taxpayer has not undertaken (or has not exhausted) these legal remedies. In that case, the approach that would be the most consistent with the basic structure of the mutual agreement procedure would be to apply the same general principles when arbitration is involved. Thus, the legal remedies would be suspended pending the outcome of the mutual agreement procedure involving the arbitration of the issues that the competent authorities are unable to resolve and a tentative mutual agreement would be reached on the basis of that decision. As in other mutual agreement procedure cases, that agreement would then be presented to the taxpayer who would have to choose to accept the agreement, which would require abandoning any remaining domestic legal remedies, or reject the agreement to pursue these remedies.

60. This approach is in line with the nature of the arbitration process set out in paragraph 5. The purpose of that process is to allow the competent authorities to reach a conclusion on the unresolved issues that prevent an agreement from being reached. When that agreement is achieved though the aid of arbitration, the essential character of the mutual agreement remains the same.

61. In some cases, this approach will mean that the parties will have to expend time and resources in an arbitration process that will lead to a mutual agreement that will not be accepted by the taxpayer. As a practical matter, however, experience shows that there are very few cases where the taxpayer rejects a mutual agreement to resort to domestic legal remedies. Also, in these rare cases, one would expect the domestic courts or administrative tribunals to take note of the fact that the taxpayer had been offered an administrative solution to his case that would have bound both States.

62. In some States, unresolved issues between competent authorities may only be submitted to arbitration if domestic legal remedies are no longer available. In order to implement an arbitration approach, these States could consider the alternative approach of requiring a person to waive the right to pursue domestic legal remedies before arbitration can take place. This could be done by replacing the second sentence of the paragraph by “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 these issues or if a decision on these issues has already been rendered by such a court or administrative tribunal." To avoid a situation where a taxpayer would be required to waive domestic legal remedies without any assurance as to the outcome of the case, it would then be important to also modify the paragraph to include a mechanism that would guarantee, for example, that double taxation would in fact be relieved. Also, since the taxpayer would then renounce the right to be heard by domestic courts, the paragraph should also be modified to ensure that sufficient legal safeguards are granted to the taxpayer as regards his participation in the arbitration process to meet the requirements that may exist under domestic law for such a renunciation to be acceptable under the applicable legal system (e.g. in some countries, such renunciation might not be effective if the person were not guaranteed the right to be heard orally during the arbitration).

63. Paragraph 5 provides that, unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that 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 the decisions reached in the arbitral process will be reflected in the mutual agreement that will be presented to these persons.

64. As noted in subparagraph 58b) above, where a mutual agreement is reached before domestic legal remedies have been exhausted, it is normal for the competent authorities to require, as a condition for the application of the agreement, that the persons affected renounce the exercise of domestic legal remedies that may still exist as regards the issues covered by the agreement. Without such renunciation, a subsequent court decision could indeed prevent the competent authorities from applying the agreement. Thus, for the purpose of paragraph 5, if a person to whom the mutual agreement that implements the arbitration decision has been presented does not agree to renounce the exercise of domestic legal remedies, that person must be considered not to have accepted that agreement.

65. The arbitration decision 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.

66. 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 a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision or 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."

67. The last sentence of the paragraph leaves the mode of application of the arbitration process to be settled by mutual agreement. Some aspects could also be covered in the Article itself, a protocol or through an exchange of diplomatic notes. Whatever form the agreement takes, it 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. A sample form of such agreement is provided in the annex together with comments on the procedural rules that it puts forward.

Use of other supplementary dispute resolution mechanisms

68. 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 51 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. In such situations the mediator listens to the positions of each party and then communicates a view of the strengths and weaknesses of each side. This helps each party to better understand its own position and that of the other party. Some tax administrations are now successfully using mediation to resolve internal disputes and the extension of such techniques to mutual agreement procedures could be useful.

69. 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. This is often done in judicial procedures where factual matters are referred to an independent party who makes factual findings which are then submitted to the court. Unlike the dispute resolution mechanism which is established in paragraph 5, these procedures are not binding on the parties but nonetheless can be helpful in allowing them to reach a decision before an issue would have to be submitted to arbitration under that paragraph.

Add the following Annex to the Commentary:

ANNEX

SAMPLE MUTUAL AGREEMENT ON ARBITRATION

1. 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 provided for in paragraph 5 of the Article (see paragraph 67 above). Paragraphs 2 to 43 below discuss the various provisions of the agreement and, in some cases, put forward alternatives. Competent authorities are of course free to modify, add or delete any provisions of this sample agreement when concluding their bilateral agreement.

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 establish 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]. The competent authorities may modify or supplement this agreement by an exchange of letters between them.

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 no decision on the same issues has already been rendered by a court or administrative tribunal of the States. 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. Failure to communicate the Terms of Reference. If the Terms of Reference have not been communicated to the person who made the request for arbitration within the period referred to in paragraph 3 above, that person and each competent authority may, within one month after the end of that period, communicate in writing to each other a list of issues to be resolved by the arbitration. All the lists so communicated during that period shall constitute the tentative Terms of Reference. Within one month after all the arbitrators have been appointed as provided in paragraph 5 below, the arbitrators shall communicate to the competent authorities and the person who made the request for arbitration a revised version of the tentative Terms of Reference based on the lists so communicated. Within one month after the revised version has been received by both of them, the competent authorities will have the possibility to agree on different Terms of Reference and to communicate them in writing to the arbitrators and the person who made the request for arbitration. If they do so within that period, these different Terms of Reference shall constitute the Terms of Reference for the case. If no different Terms of Reference have been agreed to between the competent authorities and communicated in writing within that period, the revised version of the tentative Terms of Reference prepared by the arbitrators shall constitute the Terms of Reference for the case.

5. Selection of arbitrators. Within three months after the Terms of Reference have been received by the person who made the request for arbitration or, where paragraph 4 applies, within four months after the request for arbitration has been received by both competent authorities, the competent authorities shall each appoint one arbitrator. Within two months of the latter appointment, the arbitrators so appointed will appoint a

third arbitrator who will function as Chair. If any appointment is not made within the required time period, the arbitrator(s) 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 all arbitrators …. *[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]*

6. Streamlined arbitration process. If the competent authorities so indicate in the Terms of Reference (provided that these have not been agreed to after the selection of arbitrators pursuant to paragraph 4 above), the following rules shall apply to a particular case notwithstanding paragraphs 5, 11, 15, 16 and 17 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. If, at the end of that period, the arbitrator has not yet been appointed, the arbitrator 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 19.

7. 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.

8. 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. For the purposes of this agreement, where a case giving rise to arbitration was initially presented simultaneously to both competent

authorities, "the competent authority of the Contracting State to which the case giving rise to the arbitration was initially presented" means the competent authority referred to in paragraph 1 of Article 25.

9. Failure to provide information in a timely manner. Notwithstanding paragraphs 5 and 6, 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.

10. 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. Unless the competent authorities agree otherwise, any information that was not available to both competent authorities before the request for arbitration was received by both of them shall not be taken into account for purposes of the decision.

11. 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 to the same extent that he can do so during the mutual agreement procedure. In addition, with the permission of the arbitrators, the person may present his position orally during the arbitration proceedings.

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

13. 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 process will be borne by the competent authority to which the case giving rise to the arbitration was initially presented, or if presented in both States, will be shared equally; 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.

14. 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 OECD 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.

15. Arbitration decision. 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 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.

16. Time allowed for communicating the arbitration decision. 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 Chair notifies in writing the competent authorities and the person who made the request for arbitration that he has received all the information necessary to begin consideration of the case. Notwithstanding the first part of this paragraph, if at any time within two months from the date on which the last arbitrator was appointed, the Chair, with the consent of one of the competent authorities, notifies in writing the other competent authority and the person who made the request for arbitration that he has not received all the information necessary to begin consideration of the case, then

a) if the Chair receives the necessary information within two months after the date on which that notice was sent, 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 information was received by the Chair, and

b) if the Chair has not received the necessary information within two months after the date on which that notice was sent, the arbitration decision must, unless the competent authorities agree otherwise, be reached without taking into account that information even if the Chair receives it later and the decision must be communicated to the competent authorities and the person who made the request for arbitration within eight months from the date on which the notice was sent.

17. Failure to communicate the decision within the required period. In the event that the decision has not been communicated to the competent authorities within the period

provided for in paragraphs 6c or 16, the competent authorities may agree to extend that period for a period not exceeding six months or, if they fail to do so within one month from the end of the period provided for in paragraphs 6c or 16, they shall appoint a new arbitrator or arbitrators in accordance with paragraph 5 or 6a, as the case may be.

18. Final 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 8 "Communication of information and confidentiality" and 13 "Costs").

19. 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 a mutual agreement on the case that led to the arbitration.

20. Where no arbitration decision will be provided. Notwithstanding paragraphs 6**,** 15, 16 and 17, 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]

General approach of the sample agreement

2. A number of approaches can be taken to structuring the arbitral process which is used to supplement the MAP. Under one approach, which might be referred to as the "independent opinion" approach, the arbitrators would be presented with the facts and arguments by the parties based on the applicable law, and would then reach their own independent decision which would be based on a written, reasoned analysis of the facts involved and applicable legal sources.

3. Alternatively, under the so-called "last best offer" or "final offer" approach, each competent authority would be required to give to the arbitral panel a proposed resolution of the issue involved and the arbitral panel would choose between the two proposals which were presented to it. There are obviously a number of variations between these two positions. For example, the arbitrators could reach an independent decision but would not be required to submit a written decision but simply their conclusions. To some extent, the appropriate method depends on the type of issue to be decided.

4. The above sample agreement takes as its starting point the "independent opinion" approach which is thus the generally applicable process but, in recognition of the fact that many cases, especially those which involve primarily factual questions, may be best handled differently, it also provides for an alternative "streamlined" process, based on the "last best offer" or "final offer" approach. Competent authorities can therefore agree to use that streamlined process on a case-by-case basis. Competent authorities may of course adopt this combined approach, adopt the streamlined process as the generally applicable process with the independent opinion as an option in some circumstances or limit themselves to only one of the two approaches.

The request for arbitration

5. 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.

6. In order to determine that the conditions of paragraph 5 of Article 25 have been met (see paragraph 56 of the Commentary on this Article) the request should be accompanied by statements indicating that no decision on these issues has already been rendered by domestic courts or administrative tribunals in either Contracting State.

7. 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.

8. 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 were required to initiate the mutual agreement procedure**.**

Terms of Reference

9. Paragraph 3 of the sample agreement refers to the "Terms of Reference", which is the document that sets forth the questions to be resolved by the arbitrators. It establishes the jurisdictional basis for the issues which are to be decided by the arbitral panel. It is to be established by the competent authorities who may wish in that connection to consult with the person who made the request for arbitration. If the competent authorities cannot agree on the Terms of Reference within the period provided for in paragraph 3, some mechanism is necessary to ensure that the procedure goes forward. Paragraph 4 provides for that eventuality.

10. Whilst the Terms of Reference will generally be limited to a particular issue or set of issues, it would be possible for the competent authorities, given the nature of the case and the interrelated nature of the issues, to draft the Terms of Reference so that the whole case (and not only certain specific issues) be submitted to arbitration.

11. 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 process

12. The normal process 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. Generally, it is important that the arbitrators support their decision with the reasoning leading to it. Showing the method through which the decision was reached may be important in assuring acceptance of the decision.

13. In some cases, however, the unresolved issues will be primarily factual and the decision may be simply a statement of the final disposition, for example a determination of the amount of adjustments to the income and deductions of the respective related parties. Such circumstances will often arise in transfer pricing cases, where the unresolved issue may be simply the determination of an arm's length transfer price or range of prices (although there are other transfer pricing cases that involve complex factual issues); there are also cases in which an analogous principle may apply, for example, the determination of the existence of a permanent establishment. In some cases, the decision may be a statement of the factual premises on which the appropriate legal principles should then be applied by the competent authorities. Paragraph 5 of the sample agreement provides a streamlined process which the competent authorities may wish to apply in these types of cases. That process, which will then override other procedural rules of the sample agreement, takes the form of the so-called "last best offer" or "final offer" arbitration, under which each competent authority is required to give to an arbitrator appointed by common consent that competent authority's 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 process through the Terms of Reference applicable to a particular case.

Selection of arbitrators

14. Paragraph 5 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 process described in the preceding paragraph or by providing for more than one arbitrator to be appointed by each competent authority). Normally, the two competent authorities will each appoint one arbitrator. 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 (a different deadline is provided for cases where the competent authorities do not agree on the Terms of Reference within the required period). The arbitrators thus appointed will select a Chair who must be appointed within two months of the time at which the last of the initial appointments was made. If the competent authorities do not appoint an arbitrator during the required period, or if the arbitrators so appointed do not appoint the third arbitrator within the required period, the paragraph provides that the appointment will be made by the Director of the OECD Centre for Tax Policy and Administration. The competent authorities may, of course,

provide for other ways to address these rare situations but it seems important to provide for an independent appointing authority to solve any deadlock in the selection of the arbitrators.

15. 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 and in the interests of the arbitrators to have a qualified Chair. However, it might be possible to develop a list of qualified persons to facilitate the appointment process and this function could be developed by the Committee on Fiscal Affairs. It is important that the Chair of the panel have experience with the types of procedural, evidentiary and logistical issues which are likely to arise in the course of the arbitral proceedings as well as having familiarity with tax issues. There may be advantages in having representatives of each Contracting State appointed as arbitrators as they would be familiar with this type of issue. Thus it should be possible to appoint to the panel governmental officials who have not been directly involved in the case. 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.

16. Paragraph 9 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 approach taken by the sample agreement is to allow the competent authorities to 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. Also, it would be possible to provide in the agreement that if within an additional period (e.g. one year), the taxpayer still had not provided the necessary information for the competent authorities to properly evaluate the issue, the issue would no longer be required to be submitted to arbitration.

Communication of information and confidentiality

17. 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 8 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

18. 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. It should be made clear in the procedural rules that as general matter, the factual material on which the arbitral panel will base its decision will be that developed in the mutual agreement procedure. Only in special situations would the panel be allowed to investigate factual issues which had not been developed in the earlier stages of the case.

19. Paragraph 10 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. Also, whilst the arbitrators will have access to all information necessary to decide the issues submitted to arbitration, including confidential information, any information that was not available to both competent authorities shall not be taken into account by the arbitrators unless the competent authorities agree otherwise.

Taxpayer participation in the supplementary dispute resolution process

20. Paragraph 11 of the sample agreement provides that the person requesting arbitration, either directly or through his representatives, is entitled to present a written submission to the arbitrators and, if the arbitrators agree, to make an oral presentation during a meeting of the arbitrators.

Practical arrangements

21. A number of practical arrangements will need to be made in connection with the actual functioning of the arbitral process. 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.

22. 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 process. This is the approach put forward in paragraph 12 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).

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

24. 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 10 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).

25. 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

26. Different costs may arise in relation to the arbitration process and it should be clear who should bear these costs. Paragraph 13 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.

27. 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.

28. The fees to be paid to the arbitrators are likely to be one of the major costs of the arbitration process. 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.

29. The fees and the travel, telecommunication and secretariat costs of the other arbitrators will, however, be shared equally by the competent authorities. The competent authorities will normally agree to incur these costs 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.

30. The costs related to the meetings of the arbitral panel, including those of the administrative personnel necessary for the conduct of the arbitration process, 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 12 of the sample 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.

31. The other costs (not including any costs resulting from the taxpayers' participation in the process) 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.

32. As indicated in paragraph 13 of the sample agreement, 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

33. 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 14 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 *OECD 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.

34. 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.

35. 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

36. Paragraph 15 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. 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 relevant participants.

37. Pursuant to paragraph 16, 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 Chair notifies in writing the competent authorities and the person

who made the request for arbitration that he has received all of the information necessary to begin consideration of the case. However, at any time within two months from the date on which the last arbitrator was appointed, the Chair, with the consent of one of the competent authorities, may notify in writing the other competent authority and the person who made the request for arbitration that he has not received all the information necessary to begin consideration of the case. In that case, a further two months will be given for the necessary information to be sent to the Chair. If the information is not received by the Chair within that period, it is provided that the decision will be rendered within the next six months without taking that information into account (unless both competent authorities agree otherwise). If, on the other hand, the information is received by the Chair within the two month period, that information will be taken into account and the decision will be communicated within six months from the reception of that information.

38. In order to deal with the unusual circumstances in which the arbitrators may be unable or unwilling to present an arbitration decision, paragraph 17 provides that if the decision is not communicated within the relevant period, the competent authorities may agree to extend the period for presenting the arbitration decision or, if they fail to reach such agreement within one month, appoint new arbitrators to deal with the case. In the case of the appointment of new arbitrators, the arbitration process would go back to the point where the original arbitrators were appointed and will continue with the new arbitrators.

Publication of the decision

39. 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 formal 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.

40. Paragraph 15 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

41. Once the arbitration process has provided a binding solution to the issues that the competent authorities have been unable to resolve, the competent authorities will proceed to conclude a mutual agreement that reflects that decision and that will be presented to the persons directly affected by the case. In order to avoid further delays, it is suggested that the mutual agreement that incorporates the solution arrived at should be completed and presented to the taxpayer within six months from the date of the communication of the decision. This is provided in paragraph 19 of the sample agreement.

42. Paragraph 2 of Article 25 provides that the competent authorities have the obligation to implement the agreement reached notwithstanding any time limit in their domestic law. Paragraph 5 of the Article also provides that the arbitration decision is binding on both Contracting States. Failure to assess taxpayers in accordance with the agreement or to implement the arbitration decision through the conclusion of a mutual agreement would therefore 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.

43. Paragraph 20 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 usual 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.

B. OTHER PROPOSED CHANGES TO THE COMMENTARY ON ARTICLE 25 OF THE OECD MODEL TAX CONVENTION

17. The 2004 Progress Report recognised the possibility that changes to the Commentary on Article 25 of the OECD Model Tax Convention may have a role in enhancing the effectiveness of the mutual agreement procedure. This is reflected in many of the Progress Report's proposals (which are listed in Annex 1). This section addresses the relevant proposals and includes the changes to the Commentary on Article 25 that the Committee has adopted to deal with each of them. In the changes below, the amendments to the existing Commentary are identified by ***bold italics*** for additions and ~~strikethrough~~ for deletions.

1. Time limitations

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.*

18. 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.

19. 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?

Changes to the Commentary

20. The following are the changes to the Commentary that have been 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 denial or adjustment of a claim for 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 Convention. 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 actually regards the taxation, at that stage, as contrary to the Convention, provided that a reasonably prudent person in the taxpayer's position would have been able to conclude at that stage that the taxation was not in accordance with the Convention. In such cases, notification of the fact of taxation to the taxpayer is enough. Where, however, it is only the combination of the self assessment with some other circumstance that would cause a reasonably prudent person in the taxpayer's position to conclude that the taxation was contrary to the Convention (such as a judicial decision determining the imposition of tax in a case similar to the taxpayer's to be contrary to the provisions of the Convention), the time begins to run only when the latter circumstance materialises.

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.

2. Probability of taxation not in accordance with the Convention

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.*

21. 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. It was decided 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.

22. 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).

23. In particular it was agreed to make it clearer that the "practical probability" approach does not mean that the taxpayer need prove this to a 51% probability, for example. It has also been agreed to provide 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.

Changes to the Commentary

24. The following are the changes to the Commentary that have been 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. Other examples include filing a return in a self assessment system or the active examination of a specific taxpayer reporting position in the course of an audit, to the extent that either event creates the probability of taxation not in accordance with the Convention (e.g. where the self assessment reporting position the taxpayer is required to take under a Contracting State's domestic law would, if proposed by that State as an assessment in a non-self assessment regime, give rise to the probability of taxation not in accordance with the Convention, or where circumstances such as a Contracting State's published positions or its audit practice create a significant likelihood that the active examination of a specific reporting position such as the taxpayer's will lead to proposed assessments that would give rise to the probability of taxation not in accordance with the Convention). Another example might be a case where a Contracting State's transfer pricing law requires a taxpayer to report taxable income in an amount greater than would result from the actual prices used by the taxpayer in its transactions with a related party, in order to comply with the arm's length principle, and where there is substantial doubt whether the taxpayer's related party will be able to obtain a***

corresponding adjustment in the other Contracting State in the absence of a mutual agreement procedure. 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.

12.1 Since the first steps in a mutual agreement procedure may be set in motion at a very early stage based upon the mere probability of taxation not in accordance with the Convention, the initiation of the procedure in this manner would not be considered the presentation of the case to the competent authority for the purposes of determining the start of the two-year period referred to in paragraph 5 of the Article. Paragraph 8 of the annex to the Commentary on Article 25 describes the circumstances in which that two-year period commences.

3. Denial of access to the MAP

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.*

25. 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.

Changes to the Commentary

26. The following are the changes to the Commentary that have been drafted to deal with these issues:

Add the following paragraphs immediately after paragraph 18.4 of the Commentary on Article 25, as amended in accordance with Proposal 2 above:

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. The simple fact that a charge of tax is made under an avoidance provision of domestic law should not be a reason to deny access to mutual agreement. However, where serious violations of domestic laws resulting in significant penalties are involved, some States may wish to deny access to MAP. The circumstances in which a State would deny access to MAP should be made clear in 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 procedure.

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 procedure. 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.

4. Suspension of collection of tax

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.*

27. 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.

28. 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. 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.

Changes to the Commentary

29. The following are the proposed changes to the Commentary that have been drafted to deal with these issues:

Add the following paragraphs to the Commentary on Article 25:

31.4 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.

31.5 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.

31.6 There are several reasons why suspension of the collection of tax pending resolution of a mutual agreement procedure can be a desirable policy, although many States may require legislative changes for the purpose of its implementation. Any requirement to pay a tax assessment specifically as a condition of obtaining access to the mutual agreement procedure in order to get relief from that very tax would generally be inconsistent with the policy of making the mutual agreement procedure broadly available to resolve such disputes. Even if a mutual agreement procedure ultimately eliminates any double taxation or other taxation not in accordance with the Convention, the requirement to pay tax prior to the conclusion of the mutual agreement procedure may permanently cost the taxpayer the time value of the money represented by the amount inappropriately imposed for the period prior to the mutual agreement procedure resolution, at least in the fairly common case where the respective interest policies of the relevant Contracting States do not fully compensate the taxpayer for that cost. Thus, this means that in such cases the mutual agreement procedure would not achieve the goal of fully eliminating, as an economic matter, the burden of the double taxation or other taxation not in accordance with the Convention. Moreover, even if that economic burden is ultimately removed, a requirement on the taxpayer to pay taxes on the same income to two Contracting States can impose cash flow burdens that are inconsistent with the Convention's goals of eliminating barriers to cross-border trade and investment. Finally, another unfortunate complication may be delays in the resolution of cases if a country is less willing to enter into good faith mutual agreement procedure discussions when a probable result could be the refunding of taxes already collected. 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.

5. Suspension or remission of interest and penalties

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.*

30. 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.

31. 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.

Changes to the Commentary

32. The following are the changes to the Commentary that have been drafted to deal with these issues:

Add the following paragraph to the Commentary on Article 25:

31.7 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. For example, 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.

6. MAP and corresponding adjustments

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.*

33. Paragraph 10 of the Commentary to Article 25 specifically addresses the relationship between Articles 9 and 25 (including where there is no equivalent to paragraph 2 of Article 9):

",… 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."

34. 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 was agreed to clarify 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.

Changes to the Commentary

35. The following are the changes to the Commentary that have been 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.

7. Relationship between domestic law and the MAP

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.*

36. Possible domestic law limitations on taxpayers initiating the mutual agreement procedure have already been noted, as has the general principle that States should not lightly take the view that such limitations prevent the initiation of the mutual agreement procedure (see Proposal 4 above). Other domestic law constraints may not prevent initiation of the procedure but may prevent an agreement's being reached by the competent authorities. Whilst there is no presumption that domestic law constraints operate to prevent an agreement's being reached and States have a good faith obligation to consider seriously whether an agreement can be reached notwithstanding the apparent existence of a domestic law constraint, it is acknowledged that 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.

37. 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.

Changes to the Commentary

38. The following are the changes to the Commentary that have been drafted to deal with these issues:

Replace paragraph 31 of the Commentary on Article 25 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 31.3, 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. In either case, awaiting a court decision or otherwise holding a mutual agreement procedure in abeyance while formalised domestic recourse proceedings are underway will not infringe upon, or cause time to expire from, the two-year period referred to in paragraph 5 of the Article. 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 Depending upon domestic procedures, the choice of redress is normally that of the taxpayer and in most cases it is the domestic recourse provisions such as appeals or court proceedings that are held in abeyance in favour of the less formal and bilateral nature of mutual agreement procedure.

31.3 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 thes***e*** 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.

8. Scope of paragraph 3 of Article 25

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*

39. 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 emphasizes the facilitative aspect of MAP, which contributes to ensuring the continuing relevance of tax treaties designed to last for a considerable period of time.

40. 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.

41. 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.

42. Whilst 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.

43. Since such branches are not residents of the countries involved in the potential dispute over profit attribution, the MAP 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.

44. 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.

Changes to the Commentary

45. The following are the changes to the Commentary that have been drafted to deal with these issues:

> *Replace paragraph 37 of the Commentary on Article 25 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. FOLLOW-UP TO OTHER PROPOSALS OF THE 2004 PROGRESS REPORT

46. This section describes the follow-up work done on other proposals included in the 2004 Progress Report. As explained below, the main results from that work have been the development of a Manual on Effective Mutual Agreement Procedure (MEMAP) (see subsection 1 below) and the development of a reporting framework for mutual agreement cases (see subsection 2 below).

1. Manual on Effective Mutual Agreement Procedure

Proposal: *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 Committee.*

47. In accordance with this proposal, a Manual on Effective Mutual Agreement Procedure ("MEMAP") has been developed. This manual is available online in electronic form at www.oecd.org/ctp/memap. The MEMAP explains the various stages of the mutual agreement procedure, discusses various issues related to that procedure and, where appropriate, describes best practices.

2. MAP reporting framework

Proposal: *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.*

48. Two key objectives of the work of the Committee were to improve the timeliness of processing and completing MAP cases and to enhance the overall transparency of the MAP procedure. It was therefore agreed that Member countries would prepare and submit to the OECD annual reports containing some basic information about their MAP caseload. It was felt that such annual reports would provide valuable information to both tax administrations and taxpayers. These reports will be prepared as follows:

- Countries will be asked to report on the status of their MAP caseload for each 12-month reporting period on the basis of the table that appears in Annex 2. This table requires reporting of MAP cases for a given reporting period as follows: opening and closing inventory of MAP cases; the number of cases initiated during the year; the number of cases completed during the year; the number of cases withdrawn or closed during the year without full resolution of double taxation; and, optionally, the average cycle time for cases completed, closed or withdrawn during the year; with all of these columns broken down by the year the MAP case was initiated.
- The reports will be made available through the OECD website and will be updated annually, along with periodic updates to the country profiles that are already available through that site.

49. With this MAP reporting structure, taxpayers will have a better understanding of a country's MAP program and may be in a better position to make a decision on their course of action. Tax administrations should also find this information useful in evaluating the performance of their MAP program.

50. The definitions accompanying the reporting template are intended to ensure reasonably consistent reporting among countries, while incorporating some flexibility to recognise countries' different data collection practices. For example, some countries collect data on a calendar year basis, whereas others

collect data on the basis of a different 12-month period. The template is designed to accommodate such differences, while retaining the goal of obtaining reasonably contemporaneous statistics from reporting countries.

51. Further statistics, similar to statistics that some countries currently report (e.g. breakdown by issue, industry or treaty partner, or by reference to whether cases are domestically or foreign-initiated), could be included in the future if a consensus could be reached that such additional data would not be overly burdensome to compile and would not risk identifying individual taxpayer cases. In the meantime, countries that wish to report these additional statistics are encouraged to do so via a web-link in their country profiles.

3. Partial double taxation relief

Proposal: *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.*

52. The Committee has concluded 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.

4. Consistency, competitiveness and non-discrimination

Proposal: *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.*

53. Whilst the Committee saw this as an area for possible future work, 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 as part of other work by Working Party No. 6 on the Taxation of Multinational Enterprises.

5. Secondary adjustments

Proposal: *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.*

54. 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.

55. The Committee agreed that the issue of secondary adjustments was an important one on which work should be carried out. It therefore agreed that this issue should be further examined by Working Party No. 1 on Tax Conventions and Related Questions and Working Party No. 6 on the Taxation of Multinational Enterprises.

6. Triangular cases

Proposal: *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.*

56. The Committee 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 any issue related to triangular cases should be brought to the attention of that Working Party, which could consult with Working Party No. 6 on the Taxation of Multinational Enterprises where appropriate.

ANNEX 1

FOLLOW-UP WORK ON THE PROPOSALS INCLUDED IN THE 2004 PROGRESS REPORT

[*The proposals included in the 2004 Progress Report were divided in three groups: current proposals, proposals for future work and proposals for future study. This Annex lists all the proposals of the Progress Report and, where follow-up work was required by the Committee, refers to the part of this report that describes how the proposal has been dealt with*]

2004 PROGRESS REPORT 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.

   No follow-up work was required from the Committee.

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.

   Follow-up work: the country profiles have been periodically updated and a number of non-OECD countries have added their profile. The updated country profiles can be consulted on the OECD web site at:

   http://www.oecd.org/document/31/0,2340,en_2649_33753_29601439_1_1_1_1,00.html

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.

   No follow-up work was required from the Committee.

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.

   No follow-up work was required from the Committee.

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.

No follow-up work was required from the Committee.

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.

No follow-up work was required from the Committee.

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.

No follow-up work was required from the Committee.

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.

No follow-up work was required from the Committee.

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.

No follow-up work was required from the Committee.

2004 PROGRESS REPORT 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 [Committee].

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

Follow-up work: see section C (1) 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.

Follow-up work: see section B (1) of this Report as well as work done on the MEMAP in section C (1) of this Report.

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.

Follow-up work: see section B (2) of this Report.

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

Follow-up work: see the work done on the MEMAP in section C (1) of this Report.

5. 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.

Follow-up work: see section B (3) of this Report as well as work done on the MEMAP in section C (1) of this Report.

6. 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.

Follow-up work: see the work done on the MEMAP in section C (1) of this Report

7. 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.

Follow-up work: see section B (4) of this Report as well as the work done on the MEMAP in section C (1) of this Report.

8. 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.

Follow-up work: see section B (5) of this Report as well as the work done on the MEMAP in section C (1) of this Report.

9. 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.

Follow-up work: see the work done on the MEMAP in section C (1) of this Report.

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

Follow-up work: see section B (6) of this Report as well as the work done on the MEMAP in section C (1) of this Report.

11. 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.

No immediate follow-up work was required from the Committee.

12. 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.

Follow-up work: see section B (7) of this Report as well as the work done on the MEMAP in section C (1) of this Report.

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

Follow-up work: see work done on the MEMAP in section C (1) of this Report.

14. 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.

Follow-up work: see work done on the MEMAP in section C (1) of this.

15. 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.

Follow-up work: see work done on the MEMAP in section C (1) of this Report.

16. The [Committee] 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 [Committee] 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.

Follow-up work: see section A of this Report.

17. The [Committee] 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

Follow-up work: see section A of this Report.

2004 PROGRESS REPORT 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.

   Follow-up work: see section C (2) of this Report.

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.

   Follow-up work: see section C (3) of this Report.

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.

   Follow-up work: see section C (4) of this Report.

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.

   Follow-up work: see section C (5) of this Report.

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.

   Follow-up work: see section C (6) of this Report.

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.

   Follow-up work: see section B (8) of this Report.

ANNEX 2

MAP PROGRAM STATISTICS FOR [2006] YEAR[1]

Country: _____

If the reporting period does not correspond to the calendar year, please indicate the date when the reporting period ends: _____

Year MAP Case was Initiated	Opening Inventory on First Day of Year	Initiated During Year	Completed During Year	Ending Inventory on Last Day of Year	Closed or Withdrawn with Double Taxation During Year	Average Cycle Time for Cases Completed, Closed or Withdrawn During Year (in months)[2]
2000 or prior		---				
2001		---				
2002		---				
2003		---				
2004		---				
2005		---				
2006	---					
Total						

1 Countries may wish to provide a footnoted explanation of any aberrational figures reported in this table, particularly if that would help to maintain taxpayers' confidence in the MAP process. Also, countries may aggregate information for two or more years if the number of cases for a given year is so small as to risk providing a clue as to the identity of the taxpayers involved.

2 While countries are strongly encouraged to report average cycle times for their MAP cases, it is recognised that some countries may not consider reporting this information feasible or justified and may accordingly not include this information in their report.

DEFINITION OF TERMS USED IN REPORTING:[3]

Reporting Period: A reporting period is any 12-month period for which a competent authority prepares statistics relating to its Mutual Agreement Procedure (MAP) program. The reporting period for a specific calendar year is either that calendar year itself or any 12-month period ending during that calendar year, whichever best corresponds to the competent authority's recordkeeping practice. Thus, for example, the 2006 reporting period would be calendar year 2006 for a competent authority that maintains records on a calendar year basis, or would be the period from 1 October 2005 to 30 September 2006 for a competent authority that maintains records on the basis of a year ending on 30 September. To achieve maximum consistency in the data, countries are strongly encouraged to report on a calendar year basis, but use of a non-calendar year reporting period is acceptable if a country finds calendar year reporting too burdensome.

MAP Case: A case arising from a request made by a person pursuant to the MAP provisions of a tax convention. Cases within a competent authority's inventory would generally include both: (i) cases arising from a request submitted directly to that competent authority by the taxpayer; and (ii) cases arising from a request submitted by the taxpayer to the competent authority of the treaty partner and subsequently presented by the latter competent authority to the former competent authority. These cases are typically requests to resolve situations where taxpayers are subject to taxation not in accordance with the provisions of a relevant tax convention, predominantly situations of double taxation. It could be a case arising from a request submitted under a provision based upon Article 25(1) of the OECD Model Tax Convention, or alternatively under Article 25(3), provided that in the latter case the request is taxpayer-specific and not one for a generic interpretation of the treaty. It could also include a case in which a request is made for a determination of a taxpayer's residence in dual resident situations of the type mentioned in Article 4(2)(d) of the OECD Model Tax Convention. A MAP case for this purpose is not considered to include a request for an Advance Pricing Arrangement (APA). Whilst a case may refer to a number of issues and taxation years, it should still be considered as only one case for statistical purposes as long as the issues are similar for all the years and are expected to be dealt with at the same time with a view to resolving all issues and years collectively. For that purpose, if, within three months from the reception of the first request, a competent authority receives a subsequent request by the same person with respect to a similar issue but for a different taxation year or with respect to the same taxation year for a different issue, that same request should be considered to be part of the first request.

Year Initiated: The year (i.e. the 12-month reporting period) in which a case is initiated, as defined below. Each reporting period is associated with the calendar year in which or with which the reporting period ends. Thus, for example, a case initiated on 1 November 2006 would be considered a

[3] Adhering to these definitions will improve the accuracy and consistency of the data reported. In the exceptional case where a tax administration does not accept a definition or is unable to report based upon the definition, that administration is requested to provide a footnote explaining the difference between its reporting standard and the definition.

case initiated in the 2006 year for a competent authority keeping statistics on a calendar year basis, but would be considered a case initiated in the 2007 year for a competent authority keeping statistics on the basis of a reporting period ending on 30 September 2006. The template suggests that the report for a given reporting period should include itemized information on the disposition of cases initiated during the 5 preceding reporting periods and aggregated information for any cases initiated during any older periods. Competent authorities who are not reasonably able to provide such itemized information for some or all of the cases initiated before their first period of reporting may provide the information on an aggregated basis.

Opening Inventory: The number of pending MAP cases in a competent authority's inventory that are not completed, closed, or withdrawn (as defined below) as of the beginning of a reporting period. The opening inventory will equal the ending inventory of the previous year. These pending cases include cases where a resolution has been reached but the taxpayer has yet to officially agree to the resolution. The opening inventory by definition will not include any cases initiated during the reporting period.

Initiated Case: An "initiated" case is one that has been accepted by a competent authority. In most cases, competent authorities will accept a person's request for competent authority assistance via MAP on the date the request is considered complete, and this is commonly evidenced by a notification from the competent authority to the person that the request has been accepted. A "complete request" is one where there is sufficient information included to allow the competent authority to decide whether the objection underlying the case appears to be justified. For this purpose, a merely "protective" competent authority filing (i.e. one which is made before the expiration of a time limit on making a competent authority request, but which does not contain enough information to allow the competent authority to decide whether the objection underlying the case appears to be justified) should not be considered an "initiated" case. A case which is presented to a competent authority by the competent authority of another State (pursuant to a request submitted to the latter competent authority) would typically be considered "initiated" for purposes of the former competent authority's statistics when the former competent authority receives that presentation, unless the former competent authority promptly thereafter notifies the latter competent authority that the request is incomplete or is otherwise not accepted for MAP discussions. By definition this column will include only cases initiated during the current reporting period.

Completed Case: A case that has been resolved, whether by mutual agreement (including pursuant to arbitration) or by unilateral action on the part of the competent authority, where taxation not in accordance with a convention (including double taxation) has been alleviated in whole or in part. Generally, a case is completed on the date the taxpayer has officially accepted the resolution. At this point, the only remaining action by the tax administration should be the processing of the result of the resolution, which should be accomplished fairly promptly (e.g. within 30 days).

Ending Inventory: The number of pending MAP cases in a competent authority's inventory that are not completed, closed or withdrawn (as defined below) as of the end of a reporting period. The ending inventory will equal the opening inventory for the next year.

Closed or Withdrawn Case with Double Taxation: This column should include information on any case that has been closed by a tax administration (where there is no further recourse within the MAP provision of the relevant convention) or withdrawn by a taxpayer under circumstances where the taxation not in accordance with the convention (including double taxation) has not been alleviated. The case is considered closed by the tax administrations on the date they have provided written notification to the taxpayer that they cannot and will not be able to reach a resolution and there is no further recourse (such as arbitration) available within MAP. Countries have the option to determine how they wish to report on such cases (e.g. the number of such cases or issues closed or withdrawn with double taxation, the monetary amounts of unrelieved double taxation in such cases, the percentage amounts of unrelieved double taxation in such cases, etc.), but they should report on a consistent basis from year to year and should explain the basis on which they are reporting.

Average Cycle Time: The average time to complete a MAP case. This average shall be calculated by first aggregating the number of months it took to complete or close each case (including any withdrawn case) that was completed, closed or withdrawn during the reporting period, from the date of initiation until the date of completion, closure or withdrawal. The second step is to divide this aggregated number of months by the total number of such completed, closed, and withdrawn cases. The result is the average cycle time of a MAP case in months, or in other words, the average number of months to complete a MAP case.