Distr.: General
17 October 2008

ENGLISH ONLY

Committee of Experts on International Cooperation in Tax Matters
Fourth session
Geneva, 20-24 October 2008
Item 4 (g) of the provisional agenda
Discussion of substantive issues related to international cooperation in tax matters
Dispute resolution

Resolving issues that prevent a mutual agreement: Supplementary mechanisms for dispute resolution

Subcommittee on Dispute Resolution: Background Note*

* This paper was presented by Mr. Jacques Sasseville of the OECD Secretariat as a background document for the discussion on dispute settlement at the 4th Annual Session. It was presented in relation to the mandate of the subcommittee to cooperate with the OECD in the course of its work.

Contents

Introduction

At its 2007 meeting, the Committee of Experts on International Cooperation in Tax Matters (the Committee) considered recent developments in the area of dispute resolution, as well as possible changes to the United Nations Model Double Taxation Convention Between Developed and Developing Countries (the UN Model Tax Convention). According to its mandate,[1] the Committee focused on questions in this area of specific interest to developing countries and countries in transition. Professor Robert Waldburger, as coordinator of the subcommittee on Dispute Resolution (the subcommittee), presented a paper on dispute resolution[2] to the Committee that raised a number of such questions.

The main conclusion of the 2007 meeting was that options for the resolution of disputes arising in the mutual agreement procedure (MAP), including arbitration, should be further considered by the subcommittee. It was also decided that the subcommittee should consider both mandatory and voluntary arbitration in its work. The subcommittee was accordingly asked to continue its activities in light of the views expressed in the 2007 meeting, particularly in relation to ways of improving MAP. As indicated in the summary record of the meeting (paragraphs 66-67 of document E/C.18/2007/19), it was noted that the offer made by the Organisation for Economic Co-operation and Development (OECD) and the European Union to assist with the work in this area had been accepted.

Pursuant to the subcommittee's directive to consider options for improving the mutual agreement procedure, this report addresses the resolution of disputes that prevent contracting states from reaching agreement in the MAP and examines proposed supplementary dispute resolution mechanisms, including those discussed at the Committee's 2007 meeting.

1. Background: Why are supplementary mechanisms for dispute resolution necessary?

The free flow of international trade and investment and the transfer of technology all play important complementary roles in the economic development process in developing countries and countries in transition. By providing legal certainty that these activities will not be subject to international double taxation, tax conventions encourage foreign investors to participate in the economic life of these countries and thereby to contribute to their growth and prosperity.

Given the scope and complexity of the issues that a tax convention must address, the states party to a tax convention (hereinafter referred to as the "contracting states") will inevitably have occasional differences of view on how the convention should be applied in specific cases. In the absence of a mechanism to resolve such disagreements, the certainty provided by the tax convention may be compromised.

A mechanism for dispute resolution, such as the MAP provided for in Article 25 of the UN Model Tax Convention, is thus an essential component of any tax convention. As discussed below, however, certain shortcomings in the traditional Article 25 MAP make the consideration of supplementary dispute resolution mechanisms necessary and appropriate.

Paragraph 2 of Article 25 of the UN Model Tax Convention provides that the competent authorities shall endeavour to resolve by mutual agreement cases of taxation not in accordance with the Convention. Paragraph

[1] Economic and Social Council Resolution 2004/69.
[2] "Dispute Resolution" (E/C.18/2007/CRP.7).

3 of Article 25 similarly provides that the competent authorities shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention.

This language does not oblige the contracting states to reach agreement in the MAP, but only to use their best efforts to do so. As a result, there will occasionally be circumstances in which the competent authorities are unable to agree on a MAP resolution and the MAP case is closed without an agreement. In such situations, there may be unrelieved double taxation or taxation not in accordance with the convention.

The language of Article 25 similarly does not oblige the contracting states to reach timely agreement in the MAP. Where taxation not in accordance with the convention remains unresolved for an unreasonably long period, taxpayers may face many of the same burdens that they would face in a situation in which there is no competent authority agreement in the MAP.

This inability to ensure a final (or timely) resolution of MAP cases is one of the primary obstacles to an effective MAP. When a taxpayer or a tax administration is unsure that a matter will be resolved through the MAP, it may be hesitant to commit time and resources to seeking a MAP resolution. In addition, a competent authority may not take all possible steps to find a resolution through the MAP where there is no obligation to do so and no mechanism in place to break a stalemate in MAP negotiations.

In light of these shortcomings of the MAP, many tax administrations and taxpayers believe that the MAP could be improved through the addition of supplementary dispute resolution techniques to resolve issues that have prevented competent authorities from reaching agreement in the MAP. These techniques would be incorporated into the MAP, not as an alternative method of resolving tax treaty disputes, but as a tool to ensure that the competent authorities are able to reach an agreed solution to a taxpayer's case.

Supplementary dispute resolution mechanisms should increase the effectiveness of the MAP even in cases in which they are not used. Their contributions to the overall success of a MAP program may include the following:

- Greater use of the MAP. The MAP plays an essential role in assuring that an income tax convention is properly interpreted and applied. Where taxpayers or tax administrations are reluctant to use the MAP because of concerns that no resolution will be reached, this role may be undermined. Where tax administrations and taxpayers can be sure that the time and resources they put into the MAP will lead to a resolution, however, they will be encouraged to make use of the MAP.

- More efficient use of the MAP. The existence of supplementary dispute resolution mechanisms may encourage competent authorities to conduct their MAP consultations more efficiently, with a view to resolving MAP cases before these mechanisms are triggered. A more efficient MAP will in turn assure optimal use of scarce tax administration resources and build taxpayer confidence in the MAP process.

- Greater competent authority cooperation. The goal of resolving MAP cases before supplementary dispute resolution mechanisms are triggered may also encourage more flexible negotiating positions and a more collaborative approach to problem solving in MAP discussions. Greater co-operation will enhance the competent authorities' working relationship and should itself contribute to the efficiency of the MAP.

Where no agreement is reached in the MAP, a taxpayer that has taken appropriate measures to protect its ability to pursue domestic relief procedures (such as court or administrative appeals procedures) may be expected to do so in one or both of the contracting states. By guaranteeing a resolution, however, supplementary dispute resolution mechanisms should also help to reduce the likelihood of costly and time-consuming domestic proceedings, as well as potentially inconsistent court decisions.

A final significant point to note is that the certainty provided by some supplementary dispute resolution mechanisms – that is, the certainty that disputes arising under a convention will be resolved – should reinforce the role of tax conventions in encouraging international flows of trade, investment, and technology to developing countries and countries in transition, and thereby contribute to these countries' development.

2. Mediation

A first supplementary dispute resolution mechanism that has been suggested for use in the MAP is mediation. Like other supplementary dispute resolution mechanisms, provision for mediation may be made pursuant to the authority granted by Article 25(4) of the UN Model Convention to develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the MAP.

Mediation is a form of dispute resolution that has been used in a wide variety of contexts. In mediation, a neutral and impartial third party (a "mediator") assists the two parties to a dispute in reaching an agreement by using specialized techniques and skills to open dialogue and to improve communication. In the MAP, the mediator's focus would be on the process and conduct of the competent authorities' negotiations, not on the substantive international tax issue(s) that are the object of the dispute. Accordingly, although it could be helpful for a mediator to have some expertise in international tax matters, it is not essential.

By its nature – and in contrast to certain other supplementary dispute resolution mechanisms – mediation does not itself resolve the issues that the competent authorities are unable to resolve. In other words, the mediator would not himself or herself come to a decision. As described above, the mediator would use specific skills to provide process-related assistance, with a view to facilitating competent authority agreement within the framework of the MAP.

Contributions that a mediator may make to MAP discussions include:

- Bringing an independent perspective to MAP negotiations.
- Articulating the relevant facts in an impartial and unbiased manner.
- Clarifying the specific area(s) of disagreement, and precisely identifying the issue(s) to be resolved, in an impartial and unbiased manner.
- Emphasizing and reinforcing the goals of collaboration and co-operation in the MAP.
- Discouraging an adversarial MAP process and bringing a problem-solving focus to MAP discussions.
- Assisting the competent authorities in identifying potential alternative opportunities for resolution that have not been previously considered.

- Identifying broader systemic or procedural issues that may create more general obstacles to reaching a MAP resolution

Because the role of the mediator is to facilitate competent authority consultation and agreement, mediation does not require the same detailed rules for its implementation as, for example, an arbitration procedure. The competent authorities may accordingly provide for mediation in a general manner (for example, once the consideration of a MAP case has exceeded a certain time threshold) or on an ad hoc basis in specific cases.

However provision for mediation is made, it would be expected that mediators would be made to subject to the same rules as the competent authorities regarding the communication and confidentiality of taxpayer information related to MAP cases.

3. Conciliation

An additional supplementary dispute resolution mechanism that could prove useful in the MAP is conciliation.

Like mediation, conciliation involves the use of an independent third party (a "conciliator") with the same specialized skills and expertise as a mediator (for example, skills in facilitating communication and the negotiation process) to assist the two parties to a dispute in reaching an agreement. Conciliation may accordingly make the same contributions to MAP discussions (described above) as mediation.

Unlike a mediator, however, a conciliator will also necessarily have expert knowledge of the field in which the dispute arises – that is, in a MAP dispute, the field of international tax. The conciliator will accordingly take a more active role with respect to the subject matter of the MAP discussion, and will do more than simply facilitate the MAP process and competent authority consultation. In the MAP, for example, a conciliator could make suggestions for a potential resolution or provide substantive advice in the same manner as an expert. The competent authorities will themselves determine the extent to which they make use of a conciliator's international tax knowledge and expertise.

The extent to which the competent authorities accept substantive advice or suggestions provided by a conciliator is also left to their discretion. Like mediation, conciliation does not itself resolve the issues that the competent authorities are unable to resolve – the conciliator would not himself or herself come to a decision.

As with mediation, conciliation does not require detailed rules for its implementation, and could be provided for by the competent authorities in a general manner or on an ad hoc basis in specific cases. In addition, it would be expected that conciliators would be made to subject to the same rules as the competent authorities regarding the communication and confidentiality of taxpayer information related to MAP cases.

4. Arbitration

Arbitration is a technique for the resolution of disputes in which the parties to a dispute refer the matter to one or more independent persons, referred to as "arbitrators" or an "arbitral panel". The arbitrators are responsible for reaching a decision with respect to the matters submitted to them by the parties, and the parties agree in advance to be bound by the arbitrators' decision.

Arbitration is a supplementary dispute resolution mechanism that has been endorsed for use in the MAP by a number of tax administrations and also enjoys broad support in the international business community.[3]

[3] See page 6 of "Dispute resolution/arbitration in tax treaty disputes" (document E/C.18/2006/8), the paper prepared by Professor

Although the number of bilateral tax conventions that contain arbitration provisions is small,[4] the European Union's multilateral Arbitration Convention[5] (the EU Arbitration Convention) has provided since January 1, 1995, for mandatory arbitration in transfer pricing MAP cases in which EU Member States cannot reach mutual agreement within two years of the date the case was first submitted to one of the competent authorities of the Member States involved.

In addition, recent work at the OECD has led to the development of a model provision for mandatory arbitration in the MAP (the model arbitration provision), together with accompanying commentary and a sample mutual agreement to implement the arbitration procedure. In July 2008, the OECD's Committee on Fiscal Affairs approved the inclusion of the model arbitration provision in the 2008 update of the OECD Model Tax Convention on Income and on Capital (the OECD Model).[6]

In light of the number of countries that support the model arbitration provision, as well as its accompanying commentary, that provision and its accompanying sample mutual agreement on arbitration are used in this report as points of reference.

This report also addresses, as appropriate, potential divergences from the approach used in the model arbitration provision. In addition, questions of specific interest to developing countries and countries in transition[7] are addressed throughout the discussion.

4.1. Mandatory vs.voluntary arbitration

An important initial question that must be addressed with respect to an arbitration provision is whether the procedure should be mandatory or voluntary. Under a mandatory arbitration provision, the contracting states are obliged to proceed to the arbitration of unresolved MAP issues. Under a voluntary arbitration procedure, in contrast, the competent authorities must generally agree before a disagreement will proceed to arbitration.

The arbitration procedures provided for by the EU Arbitration Convention and the model arbitration provision are both mandatory.

Under the EU Arbitration Convention, where the competent authorities fail to reach agreement within two years of the date the case was first submitted to one of the competent authorities, the competent authorities "*shall* set up

---

Robert Waldburger as Coordinator of the Working Group on International Tax Arbitration and presented at the second session of the Committee of Experts on International Cooperation in Tax Matters (30 October-3 November 2006). As noted in the paper, The Paris-based International Chamber of Commerce (ICC) released a model article on the arbitration of tax convention disputes. The ICC model arbitration article can be consulted at: http://www.iccwbo.org/policy/taxation/id501/index.html.

4 See, for example, the Convention Between the Government of the United States of America and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income (the "U.S.-Belgium income tax treaty"), which can be consulted at: http://www.treas.gov/offices/tax-policy/library/Belgium06.pdf.

5 The EU Arbitration Convention and the Code of Conduct for its effective implementation can be consulted at: http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/arbitration_convention/index_en.htm.

6 The 2008 Update to the OECD Model Tax Convention, which adds the model arbitration provision as paragraph 5 of Article 25, can be consulted at: http://www.oecd.org/dataoecd/20/34/41032078.pdf. The "Sample Mutual Agreement on Arbitration" is contained in an Annex to the Commentary on Article 25.

7 Many of these questions are raised in "Dispute Resolution" (document E/C.18/2007/CRP.7).

an advisory commission [*i.e.* an arbitral panel] charged with delivering its opinion on the elimination of the double taxation in question".[8]

Under the model arbitration provision, where the competent authorities fail to reach agreement within two years of the date the case was presented to the "other" competent authority (*i.e.* the competent authority other than the one to which the taxpayer initially presented its MAP case), "any unresolved issued arising from the case *shall* be submitted to arbitration if the [taxpayer] so requests".[9]

As these two arbitration provisions illustrate, mandatory arbitration provisions may take different approaches to designating the party which must initiate the arbitration procedure. Under the EU Arbitration Convention, the contracting state that took the initial action which results, or is likely to result, in double taxation generally takes the initiative to establish the arbitral panel and arrange for its meetings.[10] Under the model arbitration provision, the taxpayer takes the initiative by submitting a request for arbitration to one of the competent authorities.[11]

In general, a mandatory arbitration procedure in which the taxpayer is responsible for initiating arbitration should be expected to lead to the more timely referral of unresolved MAP issues to arbitration, given the taxpayer's direct and immediate interest in obtaining relief from the double taxation which motivated its initial MAP request. Although contracting states will generally uphold the obligations they assume in their tax conventions, they will not have the same incentive promptly to refer the issues in unresolved MAP cases to arbitration. Competent authorities may, moreover, delay the initiation of an arbitration procedure which could potentially result in a loss of tax revenue.

In contrast to mandatory arbitration procedures, under a voluntary arbitration procedure both competent authorities must generally agree to submit unresolved MAP issues to arbitration once the arbitration provision has been triggered. A voluntary arbitration provision could provide, for example, that the competent authorities may agree to submit to arbitration any unresolved issues arising from a MAP case where the competent authorities fail to reach agreement on those issues within a certain period after the date the case was submitted to the other competent authority.

Some countries may prefer voluntary arbitration procedures because they allow greater control over the types of cases that may potentially proceed to arbitration. In certain circumstances, a competent authority may consider it unacceptable to compromise its position with respect to a specific issue – and thus that it is not appropriate for the issue to be submitted to arbitration. Voluntary arbitration is thus one manner in which countries may demonstrate some commitment to the resolution of MAP disputes and at the same time preserve flexibility as to the issues that are subject to the arbitration procedure. Voluntary arbitration may also be viewed as a way to allow countries to develop familiarity and experience with the procedure without requiring them to make the same sort of commitment that a mandatory arbitration procedure would require.

Voluntary arbitration procedures may also be preferred by countries which are concerned about the potential number of cases that could proceed to arbitration. This may be of particular concern to countries with large numbers of cases in inventory and/or limited competent authority resources. These countries may similarly have concerns about the potential costs of arbitration procedures.

A few voluntary arbitrary provisions have been included in treaties but they do not appear to have had much impact. For example, prior to its amendment by a 2006 Protocol, the MAP article of the United States-Germany

---

[8] Article 7(1) of the EU Arbitration Convention (emphasis added).

[9] Article 25(5) of the OECD Model Tax Convention (emphasis added).

[10] See Article 4.2(a) of the EU Arbitration Convention Code of Conduct, which can be consulted at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:176:0008:0012:EN:PDF.

[11] See paragraph 1 of the Sample Mutual Agreement on Arbitration referred to in note 7, above.

income tax treaty provided that the competent authorities could agree to submit unresolved issues to arbitration.[12] No arbitration procedure was ever initiated under that provision, which has now been replaced by a mandatory arbitration provision. Similarly, in 1995, a voluntary arbitration provision was inserted in the Canada-United States income tax treaty[13] but never came into force. The recent Protocol concluded by Canada and the United States in 2007 has now replaced that dormant provision with a mandatory arbitration provision.[14]

Certain other arbitration procedures may be described as not entirely mandatory because the competent authorities may agree that the issues in a particular case are not suitable for determination in arbitration. The arbitration provisions in the MAP articles of the United States-Germany income tax treaty and the United States-Belgium income tax treaty are examples of this type of arbitration procedure.[15] Under such procedures there must be an agreement between both competent authorities not to proceed to arbitration. A single competent authority, however, cannot unilaterally prevent unresolved MAP issues from being submitted to arbitration.

Practical experience with both mandatory and voluntary arbitration of unresolved MAP issues is limited. As indicated above, some arbitration procedures have never been used because contracting states have never reached agreement on their implementation.

Notwithstanding this lack of experience, mandatory arbitration provisions may be expected to make a greater contribution to an effective and efficient MAP by ensuring the timely and final resolution of all MAP cases. Mandatory arbitration may also be more likely to give the assurance to potential investors that any tax issue that will arise unde a tax treaty concluded by a country in which they invest will be settled according to internationally-agreed principles. As one of the main objectives pursued by the conclusion of tax treaties is to remove impediments to cross-border investment flows, it seems clear that a process whch ensures the resolution of all disputes related to a treaty is more likely to achieve that objective. Not surprisingly, mandatory arbitration provisions are a common feature of bilateral investment agreements.

Where a country is unable to agree to include mandatory arbitration in a tax treaty but is considering the inclusion of a voluntary arbitration provision, it may be advisable to frame such a provision in a way that would provide for arbitration unless the competent authorities expressly reject the use of that procedure in a particular case, as was done in the recent arbitration provisions in the MAP articles of the United States-Germany income tax treaty and the United States-Belgium income tax treaty. Where competent authorities are provided the discretion to exclude particular MAP cases from arbitration, the use of such discretion should be carefully considered in light of the certainty regarding the MAP that the arbitration procedure is intended to foster.

Contracting states must, of course, verify that the submission of tax issues for decision by an arbitral panel (whether mandatory or voluntary) is consistent with their domestic law, including, for example, relevant provisions concerning the competent authority function. In general, the arbitrators should not be viewed as performing a competent authority function, but rather as resolving a particular issue which is preventing agreement in the MAP. In addition, any MAP resolution that is facilitated by the arbitration procedure will be

---

12 See Article 25(5) of the United States-Germany income tax treaty, prior to its amendment by the 2006 Protocol ("If a disagreement cannot be resolved by the competent authorities it may, if both competent authorities agree, be submitted for arbitration. The procedures shall be agreed upon and shall be established between the Contracting States by notes to be exchanged through diplomatic channels.").

13 See Article XXVI(6) of the Canada-United States income tax treaty.

14 See Article 21 of the 2007 Protocol, which may be consulted at: http://www.treas.gov/offices/tax-policy/library/CanadaProtocol07.pdf.

15 The relevant language of the MAP articles of these treaties provides that unresolved MAP issues shall be resolved through arbitration if"the case is not a particular case that the competent authorities agree, before the date on which arbitration proceedings would otherwise have begun, is not suitable for determination by arbitration".

formalised by the competent authorities themselves in an agreement concluded pursuant to their general Article 25 authority.

4.2 Scope of arbitration

A second important question that must be addressed with respect to arbitration is the scope of the arbitration procedure – that is, what issues may be referred to the arbitral panel for decision?

In general, arbitration should be expected to make the greatest contribution to the effectiveness of the MAP where there are no limitations on the types of MAP cases that may be referred to arbitration. Consistent with this view, the model arbitration provision allows a taxpayer to request arbitration, subject to certain conditions, with respect to any unresolved issues that have prevented the competent authorities from reaching a mutual agreement.

Contracting states may, of course, limit the scope of a MAP arbitration provision. For example, the relevant paragraph of the MAP article (or the implementing mutual agreement) may provide that the arbitration procedure will apply only to MAP cases involving the application of specific convention articles. Any such limitations should, however, be carefully considered in light of MAP inventories and, in particular, the types of cases in connection with which arbitration would be expected to be most useful.

In any case, where the scope of a MAP arbitration provision is limited, the contracting states should also consider providing that the competent authorities may agree, on an ad hoc basis, that arbitration may be used in respect of other types of MAP cases. Such a provision will allow the competent authorities, as appropriate, to respond to unresolved MAP issues in a flexible manner.

A related question that has been raised with respect to the scope of the arbitration procedure is whether entire cases may be brought to arbitration, or only issues that could not be resolved in the MAP.[16] In this regard, it is important briefly to address the role of arbitration (and other supplementary dispute resolution mechanisms generally) in the MAP as a whole.

Arbitration and other supplementary dispute resolution mechanisms are intended as a complement to, not a replacement of, the traditional procedure for reaching competent authority agreement through the MAP. It is accordingly important to note the following characteristics of the arbitration procedure:

- The role of the arbitrators is limited to resolving issues that could not be resolved by mutual agreement. The arbitration decision with respect to those issues, and the consequences that flow from it, are incorporated into a MAP agreement, which is formalised and implemented like any other MAP agreement. The issue(s) resolved through arbitration may be central to the MAP resolution, but, as a formal matter, the case is resolved through the MAP.

- Arbitration is triggered only after the competent authorities have already had a reasonable opportunity (as defined by the contracting states) to reach a resolution but have failed to come to agreement. Under the model arbitration provision, the competent authorities have two years from the presentation of the case to the other competent authority before arbitration is triggered.

[16] See page 3 of "Dispute Resolution".

- Even where a MAP case has entered into arbitration, under the sample mutual agreement on arbitration the competent authorities may still resolve the case by mutual agreement at any time before the arbitrators have delivered their decision. Where the competent authorities so resolve the outstanding issues, the arbitration procedure is terminated and the competent authorities formalise and implement their agreement following their standard procedure.

4.3. How does a MAP case get into arbitration?

Under the model arbitration provision, there are three requirements to trigger the arbitration procedure:

1. The taxpayer has presented its 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 in taxation not in accordance with the convention;

2. The competent authorities are unable to reach agreement to resolve the MAP case within two years from the presentation of the case to the competent authority of the other contracting state; and

3. The taxpayer requests that any unresolved issues arising from the case be submitted to arbitration.

In general, two years from the presentation of the case to the competent authority of the other contracting state is considered a reasonable deadline to reach a MAP resolution. The model arbitration provision accordingly provides the competent authorities with two years to resolve a MAP case before the arbitration procedure may be triggered.

As with any other deadline in the MAP, this time frame may be modified as appropriate to take into account the specific circumstances of the contracting states. Relevant considerations may include, for example, their respective MAP inventories, the types of MAP cases in inventory, and the resources available to the competent authorities. Contracting states may also wish to provide that this deadline may be extended for MAP cases with particularly complex facts.

Contracting states should consider, however, that an arbitration procedure that is triggered only after an unreasonably long time frame may not be as effective in promoting an efficient MAP and greater competent authority co-operation.

As noted above, the model arbitration provision is also mandatory: if the competent authorities have not resolved a MAP case within the two-year deadline, the contracting states must submit the case to arbitration if the taxpayer so requests. Including the model arbitration provision in a tax convention will thus generally guarantee a resolution in all MAP cases under that relevant tax convention.

In determining how a MAP case gets into arbitration, contracting states must also consider more generally the interaction of the arbitration procedure with domestic law remedies such as judicial or administrative procedures. Under the model arbitration provision, unresolved issues shall not be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either contracting state.

The exclusion from the arbitration procedure of issues that have already been resolved through a domestic law process is necessary in order for the arbitration procedure to be effective and to avoid the risk of conflicting decisions. This approach is consistent with the general MAP practice of most countries, under which:

- Taxpayers will typically not be permitted simultaneously to pursue both the MAP and domestic law remedies. In general, tax administrations will prefer that domestic law recourse procedures are suspended or put on hold in favour of seeking a bilateral resolution of a case through the MAP. If, however, the taxpayer does not agree to do so, MAP consideration of the case may be put on hold until domestic law remedies are exhausted.

- Under many countries' MAP procedures, a taxpayer is entitled to reject a MAP agreement and then pursue any and all available domestic remedies. Where, however, a taxpayer chooses to accept the MAP resolution, the taxpayer may typically be asked to give up its rights to pursue domestic law remedies with respect to the issues resolved in the MAP.

- In the event that domestic law remedies have been pursued and exhausted, the tax authorities of certain contracting states may take the position that they must follow the decision reached in the domestic forum, and, accordingly, that the MAP may only be used to seek relief from double taxation in the other contracting state.

These same general principles would, of course, apply in a MAP case in which unresolved issues are submitted to arbitration. As a result, where it is known in advance that a domestic court decision will limit the ability of one of the competent authorities to provide MAP relief, it will not be helpful to submit unresolved issues in the case to arbitration. Contracting states should accordingly consider the more general relationship of domestic law remedies and the MAP in structuring an arbitration procedure.

4.4. How does the arbitration procedure work?

The mechanics of the arbitration procedure are set out in the sample mutual agreement annexed to the model arbitration provision. That sample mutual agreement provides the framework for the following discussion of how the arbitration procedure should generally function.

Where the conditions for the invocation of the arbitration procedure have been satisfied, the taxpayer may submit a written request to one of the competent authorities that the unresolved issues in the MAP case be submitted to arbitration. The request for arbitration should provide sufficient information to identify the case and be accompanied by a written statement that no decision on the relevant issues has already been rendered by a court or administrative tribunal in either of the contracting states.

The competent authority that receives the request for arbitration should send a copy of the request and accompanying information to the other competent authority within ten days.

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 arbitral panel. These questions are set forth in the "Terms of Reference" for the case. The Terms of Reference may also provide procedural rules that are additional to, or different from, the procedures provided in the contracting states' general mutual agreement on arbitration.

The Terms of Reference are additionally communicated in writing to the person who made the request for arbitration.

The subcommittee on Dispute Resolution has raised the question whether a three-month period is long enough to work out the Terms of Reference in the context of the UN Model Tax Convention.[17]

In this regard, it should be noted that the issues presented in the Terms of Reference will likely have been framed in detail in the process of preparing the position paper (and any rebuttal or response paper). The issues will have been further refined in the competent authority consultations preceding the request for arbitration. As a result, preparing the Terms of Reference should largely be a matter of more formally setting forth issues that have already been identified, described and discussed.

Within three months after the Terms of Reference have been received by the person who made the request for arbitration, each of the competent authorities must appoint one arbitrator. Then, within two months of the latest of these appointments, the two arbitrators appointed by the competent authorities will appoint a third arbitrator, who will serve as the chair of the arbitral panel.

It may occur that certain of these appointments are not made within the required time period. For example, the two arbitrators may not be able to agree on the appointment of the chair of the arbitral panel. In that event, the model arbitration provision provides that the appointment shall be made by the Director of the OECD Centre for Tax Policy and Administration (CTPA) within ten days of receiving a request to that effect from the person who made the request for arbitration.

The subcommittee on Dispute Resolution has also raised questions regarding the role of the Director of the CTPA in choosing the chair of the arbitral panel, in the event of a deadlock, in the context of the UN Model Convention. Non-OECD Member countries may have reservations in providing such a role for an official of an organization of which they are not members.

The Director of the CTPA was chosen for this role because of the Director's ability quickly and impartially to identify suitable arbitrators – that is, independent persons with demonstrated knowledge and expertise in international taxation. Contracting States may, of course, provide that a different official of similar international standing and experience will perform this role (for example, the Chair of the UN Committee of Experts on International Cooperation in Tax Matters).

The model arbitration provision provides that 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. As noted by the subcommittee on Dispute Resolution, contracting states must determine whether they consider it appropriate to include government officials on an arbitral panel.

This provision is intended to ensure the availability of a broad pool of arbitrators with the required expertise in tax matters, and may also serve to lower the costs associated with the arbitration procedure.

In addition, the commentary on the sample mutual agreement makes clear that all arbitrators are to resolve the issues presented to them on a neutral and objective basis, and not as advocates for one of the contracting states. The elimination of persons involved in prior stages of the case may be expected to reduce the potential for bias in government officials appointed to an arbitral panel.

Under the model arbitration provision, for purposes of the MAP and exchange of information articles of the convention and of the domestic laws of the contracting states, the arbitrators are designated as authorised

[17] See page 5 of "Dispute Resolution".

representatives of the respective competent authorities. The arbitrators are accordingly subject to the same rules as the competent authorities regarding the communication and the confidentiality of information related to a MAP case.

The model arbitration provision provides that the competent authorities of the contracting states shall by mutual agreement determine how the arbitration proceedings will be conducted. The contracting states may thus agree, for example, that the arbitration procedure will be conducted exclusively through written submissions by the competent authorities to the arbitral panel, or that the competent authorities will submit written briefs and appear in person before the arbitral panel to present their positions.

The model arbitration provision also provides that the person who made the request for arbitration may present his position to the arbitrators in writing to the same extent that it may do so in the rest of the MAP. The person may also present its position orally during the arbitration procedure, with the arbitrators' permission, and to the extent that the contracting states determine that it is appropriate for the arbitration procedure to involve such oral presentations.

The costs associated with the arbitration procedure are another important consideration. These costs may include, but are not limited to:

- Costs related to each competent authority's participation in the arbitration proceeding (for example, travel costs and costs related to the preparation and presentation of the competent authority's views);

- The arbitrators' fees and travel costs;

- Costs connected with the facilities used to conduct the arbitration proceeding, including telecommunications costs and the costs of secretarial and administrative services; and

- Other miscellaneous costs, including the costs of translating and/or recording the proceedings.

Under the model arbitration provision, each competent authority bears its own costs as well as the costs of the arbitrator it appointed. The third arbitrator's remuneration and travel, telecommunications, and secretariat costs are borne equally by both contracting states. Costs related to the meetings of the arbitral panel and required administrative personnel are borne by the competent authority to which the MAP case was initially presented. All other costs are borne equally by the contracting states.

The manner in which the remuneration of the arbitrators will be determined is left to the discretion of the contracting states. These fees should be in an amount appropriate to ensure that qualified experts will be willing to serve on arbitral panels. The model arbitration provision suggests that a fee structure similar to that under the EU Arbitration Convention Code of Conduct may be appropriate.

The subcommittee on Dispute Resolution has questioned whether the costs of arbitration proceedings should eventually be borne by taxpayers.[18]

In general, obliging taxpayers to pay the costs of arbitration proceedings should be regarded as inconsistent with the general policy of making the MAP widely available. It should also be considered that delays in

[18] See page 5 of "Dispute Resolution".

reaching a MAP resolution are, for the most part, due to factors outside the taxpayer's control. It is accordingly inappropriate to oblige a taxpayer to pay the costs of an arbitration procedure that is triggered by such a delay.

Developing countries and countries in transition may also consider different methods to divide the shared costs of the arbitration procedure, especially in contexts in which there is a significant disparity in the level of development in the two contracting states. Depending on circumstances, using an alternative method (for example, a method based on the relative sizes of their economies) may allow for a division of costs that is more consistent with each contracting state's capacity to bear those costs.

4.5. The arbitration decision

Under the model arbitration provision, unless otherwise provided in the Terms of Reference, the decision of the arbitral panel 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 of the arbitral panel notifies the competent authorities and the person who made the request for arbitration that the panel has received all of the information necessary to begin consideration of the case.

The model arbitration provision also provides certain extensions of the time for communicating the arbitration decision in circumstances in which the arbitral panel is not timely provided with all of the necessary information. In addition, if the panel does not receive necessary information within a certain deadline, the decision of the arbitral panel will be reached taking into account the information that is available to the panel (that is, without taking into account the missing information).

As with any other deadlines in the MAP, these time frames may be modified as appropriate to take into account the specific circumstances of the contracting states. Relevant considerations may include, for example, the competent authorities' respective MAP inventories, the types of MAP cases in inventory, and the resources available to the competent authorities. Contracting states may also wish to provide that the deadline for decision may be extended in cases with particularly complex facts.

Under the model arbitration provision, the decision of the arbitral panel is determined by a simple majority of the arbitrators.[19] The arbitration decision is generally presented in writing (unless otherwise provided in the Terms of Reference) and sets forth the legal authorities upon which the arbitral panel relied and the rationale for the decision.

Under the model arbitration provision, the arbitral panel's decision must be based on the applicable provisions of the convention and, subject to these provisions, of the domestic laws of the contracting states.

Issues of treaty interpretation are to be decided by the arbitrators in light of the principles incorporated in Articles 31 to 34 of the Vienna Convention on the Law of Treaties, having regard to the Commentaries on the OECD Model Tax Convention. Under these principles, in general, tax conventions are to be interpreted in good faith in accordance with the ordinary meaning of their terms in their context and in light of their object and purpose.

---

[19] The subcommittee on Dispute Resolution has also questioned whether methods other than a majority decision might be appropriate. For example, take a situation in which one arbitrator votes for a royalty rate of 2% and the other arbitrator votes for 5%. Must the chair of the arbitral panel vote for one of these two amounts, or may the chair choose a third amount (for example, 3.5%)? See page 5 of "Dispute Resolution". It is not clear, however, whether a decision-making method that does not rely in some way on the majority decision of the arbitrators would be consistent with existing forms of arbitration.

Transfer pricing issues, and other issues relating to the application of the arm's length principle, are to be decided with reference to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

The model arbitration provision further provides that the competent authorities may designate other authorities or sources of law to be considered by the arbitrators in the Terms of Reference.

The specific process by which the arbitral panel reaches its decision may vary from case to case. The model arbitration provision provides for two alternative processes – a general process and a "streamlined" arbitration process:

- General arbitration process. Under the general process, the arbitral panel comes to an independent decision, based on the applicable legal principles as described above.

  Although the positions of the competent authorities (as well as any position submitted by the person making the request for arbitration) serve as points of reference for the arbitral panel, they do not establish any limits on, or otherwise constrain, the arbitral panel's decision with respect to the issues presented in the Terms of Reference.

- Streamlined arbitration process. The contracting states may, in the alternative, provide in the Terms of Reference that a streamlined arbitration process will apply in a particular case.

  Under the streamlined procedure, the two competent authorities appoint a single arbitrator by common consent within one month after the Terms of Reference have been received by the person who made the request for arbitration. In the event that the arbitrator has not yet been appointed at the end of that period, the Director of the OECD's CTPA shall appoint the arbitrator within ten days of receiving a request to that effect from the person who made the request for arbitration.

  Within two months of the appointment of the single arbitrator, each competent authority must present in writing to the arbitrator its reply to the questions contained in the Terms of Reference.

  Within one month of the arbitrator's receipt of the last of the competent authorities' positions, 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. The arbitrator then notifies the competent authorities of its choice and provides a short explanation of the rationale for that choice.

  An arbitration process like the streamlined arbitration process in which the arbitrator (or arbitrators) must choose one or the other of the parties' positions, rather than come to an independent decision, is commonly referred to as "pendulum" or "baseball" arbitration.

Certain other processes are used to reach arbitration decisions in commercial contexts,[20] but their suitability for use in the context of the MAP has not yet been examined.

[20] One such example is "high-low" or "bracketed" arbitration, in which the parties to a dispute agree in advance to the upper and lower limits of the arbitral panel award. This type of arbitration process is generally only used in a commercial context in which there is no dispute regarding liability but the amount of compensation must be determined. If the arbitral award falls within the agreed range, the parties are bound by the amount of the arbitral award. If the arbitral award falls outside

The specific process by which the arbitral panel reaches its decision will be determined by negotiation between the contracting states. Certain recent agreements have provided, for example, that the arbitral panel will be made up of three arbitrators, chosen as in the model arbitration provision's general process, and that the arbitral panel must choose one of the two competent authorities' positions as its decision, as in the streamlined arbitration process.[21]

The sample mutual agreement provides that, with the permission of the person that made the request for arbitration and both competent authorities, the decision of the arbitral panel will be made public in redacted form – that is, without including the names of the taxpayer(s) involved or other details that would serve to identify the parties (for example, the taxpayer's business or the details of specific transactions). The published arbitral decision should make clear that it has no formal precedential value.

As with the resolutions reached in the majority of MAP cases, however, the arbitration decision will generally be based on a taxpayer's specific facts and circumstances. Given the specificity of arbitration decisions, and the understanding that such decisions are not intended to have any value as precedent, some contracting states may question the extent to which the publication of arbitral decisions can be expected to provide useful guidance.

As noted above, the arbitration decision and the consequences that flow from it are incorporated by the competent authorities into a MAP agreement, which under the sample mutual agreement must be reached within six months from the communication to the competent authorities of the arbitration decision.

While the person that made the request for arbitration will have already been notified of the arbitration decision, the residence state competent authority must also notify the taxpayer when the relevant MAP agreement has been reached and provide the taxpayer with the details of the MAP resolution within six months from the communication of the decision.

The MAP agreement reflecting the results of the arbitration procedure is then implemented by each of the contracting states, as appropriate, like any other MAP agreement.

Depending on the effect of invoking the MAP in the relevant contracting state, the taxpayer may have the option to reject the MAP resolution reflecting the results of the arbitration procedure in the same manner as it may reject any other MAP resolution. A taxpayer will thus have the right to reject the decision of the arbitral panel, albeit indirectly, to the same extent as the taxpayer is allowed to reject a MAP resolution.

To the extent that the taxpayer has taken steps to protect its rights to seek relief in a domestic court or administrative appeals process, a taxpayer that rejects the MAP resolution may then proceed to avail itself of those domestic procedures.

---

the range, the agreed limits establish a cap and floor with respect to the amount of the arbitral award. Practice may vary as to whether the arbitral panel is informed of the upper and lower limits, or even that the parties are using high-low arbitration. In the MAP context, this form of arbitration could potentially be adapted for use in a context in which the arbitral panel must establish an arm's length value in a transfer pricing MAP case.

[21] See, for example, the Protocol Amending the Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes (signed June 1, 2006). This agreement amends the convention's existing MAP article to provide for an arbitration procedure and contains detailed provisions on the implementation of the arbitration procedure. The agreement may be consulted at http://www.treas.gov/press/releases/reports/germanprotocol06.pdf.

The sample mutual agreement provides that 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 the arbitration provision or of any other procedural rule contained in the mutual agreement implementing the arbitration procedure or the Terms of Reference. Where an arbitration 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.

The extent to which a provision allowing an arbitration decision to be challenged on procedural grounds is unclear, and will depend to a certain extent on the relevant domestic law in each of the contracting states.

It would appear in any case to be unlikely that the competent authorities would enter into a mutual agreement based on arbitration resolution characterized by procedural irregularities. In many cases, the taxpayer would also have the option simply to reject the MAP resolution and seek relief in a domestic court or administrative appeals process, where it has preserved its rights to those processes.

Conclusion

Article 25 of the UN Model Tax Convention does not oblige the contracting states to reach agreement in the MAP but only to use their best efforts to do so. As a consequence, contracting states may in some circumstances reach a stalemate in their MAP negotiations, and some MAP cases may thus be closed without an agreement.

The absence of a mechanism in Article 25 of the UN Model Tax Convention to resolve MAP cases in circumstances where the contracting states are otherwise unable to reach agreement is one of the main obstacles to an effective MAP. Both taxpayers and tax administrations may be reluctant to commit time and resources to the MAP process when there is no guarantee of a final (or timely) resolution. In addition, where there is no obligation to reach agreement in the MAP, competent authorities may not take all reasonable steps to reach an agreement. Supplementary dispute resolution mechanisms such as mediation, conciliation, and arbitration may thus contribute to a more effective MAP – and thereby encourage greater use of the MAP – by helping to guarantee a resolution in MAP cases and thereby assuring the stakeholders in the MAP process that their investment in the process will generally lead to a satisfactory outcome. These considerations have motivated the arbitration procedure in the EU Arbitration Convention and the inclusion of arbitration provisions in certain recently concluded bilateral tax conventions and the OECD Model Tax Convention, and make it appropriate to consider the inclusion of supplementary dispute resolution mechanisms in the UN Model Convention.