



## **Economic and Social Council**

Distr.: General  
5 December 2005

Original: English

---

### **Committee of Experts on International Cooperation in Tax Matters**

**First session**

Geneva, 5-9 December 2005

### **Revision of the United Nations Model Resolution of Tax Treaty Disputes\***

#### *Summary*

The present paper examines recent evolution as regards mutual agreement procedures. Both the European Union and the OECD have been working on improving dispute resolutions, including in cases of Transfer pricing adjustments. For the first time, the arbitration phase provisioned in the European Convention on Arbitration has been implemented. Within the UN context, it seems useful to improve cooperation and to promote dispute resolutions. Work may result in benchmarking best practices or adopting new methods. Further work is anyway needed to progress on that issue.

---

\* The present paper was prepared by Mr. Pascal Saint-Amans, Assistant-Director Legal Services, General Tax Directorate, France. The views and opinions expressed are those of the author and do not necessarily represent those of the United Nations.

## Contents

• • Paragraphs • Page • •	Introduction • 1–8 • 3 • •	The EU Arbitration Convention • 9–11
		<i>Paragraphs Page</i>
I.	The EU Arbitration Convention .....	9–11 4
II.	The OECD work on improving the resolution of cross-border treaty disputes .....	12–20 5
III.	Discussion of arbitration at the last meeting of the Ad Hoc Group of Experts.....	21–22 6
IV.	Options for future work.....	23–28 8

## Introduction

1. The harmful effects of international double taxation on trade of goods and services and movements of capital, technology and persons are well known. The principal goal of countries that enter into tax conventions is precisely to eliminate that double taxation so as to promote cross-border trade and investment. That goal, however, cannot be achieved to the extent that double taxation is not eliminated because countries that have entered into a tax convention adopt different views as regards the relevant facts or the interpretation of the provisions of the convention.

2. Over the last few years, the number of disputes involving tax conventions has grown as the frequency and complexity of international transactions have increased and as more and more countries have allocated additional resources to the examination of intra-group transactions.

3. The Mutual Agreement Procedure ("MAP") process, which is put forward in Article 25 of the United Nations Model Double Taxation Convention between Developed and Developing Countries (the "UN Model") and is incorporated in almost all bilateral treaties, works effectively and allows the resolution of the vast majority of disputes between most countries that have signed tax treaties. That process, however, is increasingly being put under strain. Both the volume and the complexity of MAP cases have increased sharply and this trend is certain to continue in the future.

4. Under paragraph 2 of Article 25 of the UN Model, the competent authorities "shall endeavour" to resolve MAP cases in a satisfactory manner. To carry out fully this obligation, every effort has to be made to reach a satisfactory resolution of the issues involved. Nevertheless, there is no formal requirement for the competent authorities to reach an agreement and there are therefore situations in which a tax convention dispute between two countries is simply not solved. This is detrimental to the credibility of the mutual agreement process and, more generally, raises doubts on the commitment of the respective countries to follow the provisions of their tax conventions. Since tax conventions provide the tax certainty necessary to attract foreign investment, any doubt as to a country's commitment to follow their provisions can have detrimental effect on its capacity to attract foreign investors.

5. Paragraph 36 of the Commentary on Article 25 of the UN Model includes the text of a possible arbitration provision. That paragraph reads as follows

"36. Some members of the Group of Experts supported the idea of adding to article 25 a paragraph providing for arbitration in case the competent authorities cannot resolve in mutual agreement any difficulty or doubt arising as to the interpretation or application of the Convention. An example of such an additional paragraph could read:

'If any difficulty or doubt arising as to the interpretation or application of this Convention cannot be resolved by the competent authorities in a mutual agreement procedure pursuant to the previous paragraphs of this article, the case may, if both competent authorities and taxpayer(s) agree, be submitted for arbitration, provided the taxpayer agrees in writing to be bound by the decision of the arbitration board. The

decision of the arbitration board in a particular case shall be binding on both States with respect to that case. The competent authorities shall by mutual agreement settle the procedures for such an arbitration board."

6. Apart from the fact that this paragraph is presented as a mere example of what some countries do rather than as a recommended provision, it only provides for arbitration as long as both competent authorities and the taxpayers agree and would not, therefore, ensure a final resolution of a tax convention dispute. Also, the UN Model does not provide any guidance as to how the arbitration process should work in practice.

7. Binding dispute resolution procedures are already being implemented in the trade and investment context which result in a final and binding conclusion to such disputes. As non-tax barriers to trade and investment are eliminated, tax issues assume greater and greater importance. It is therefore important to also ensure that such issues are finally resolved.

8. As explained in sections I and II below, both the European Union and the OECD have recently made significant progress in improving the process for solving tax convention disputes between countries. Given the importance of improving trade and investment flows between developing and developed countries, it seems entirely logical for the Committee of Experts to also address that issue in the context of its review of the UN Model. As indicated in section III, however, during the last meeting of the United Nations Ad Hoc Group of Experts on International Cooperation in Tax Matters, different opinions were expressed on the desirability of including arbitration provisions in the UN Model. Section IV examines some of the concerns that were then expressed and puts forward options for future work.

## **I. The EU Arbitration Convention**

9. The member States of the European Union have achieved the most significant progress in solving tax treaty disputes. These countries are bound by a multilateral convention (the "EU Arbitration Convention") that provides for the mandatory arbitration of certain cases of double taxation that are unresolved under a tax convention. That multilateral convention was concluded following a proposal for a Council directive presented by the Commission in 1976. For political reasons, that proposal was transformed into a multilateral convention that was signed on 23 July 1990 and entered into force on 1 January 1995 for an initial period of five years (and has now been renewed).

10. The multilateral convention provides a procedure for the solution of disputes concerning the double taxation of enterprises of different member States as a result of an upward adjustment of the profits of one of these enterprises in a member State. Tax conventions normally include provisions, such as paragraph 2 of Article 9, that provide for a corresponding downward adjustment of an associated enterprise but there is no obligation to resolve a dispute as regards the application of these provisions. The EU Arbitration Convention provides for the mandatory arbitration of cases where the member States are unable to agree on the elimination of double taxation within two years from the date the case has been submitted to one of the competent authorities.

11. The EU Arbitration Convention was examined at the 11th meeting of the Ad Hoc Group of Experts on International Cooperation in Tax Matters on the basis of.

note ST/SG/AC.8/2003/L.8 by Mr. Juan Lopez Rodriguez, entitled "Intermediation and Arbitration: the Arbitration Convention of the European Union for the Resolution of Transfer Pricing Disputes". Paragraphs 13 to 86 of that note analyze the background and the provisions of the Arbitration Convention in details.

## **II. The OECD work on improving the resolution of cross-border treaty disputes**

12. A few years ago, the OECD launched a major project to improve the effectiveness of the Mutual Agreement Procedure. Unlike the EU Arbitration Convention, which focuses on double taxation arising from transfer pricing adjustments, the OECD work looks at improving the resolution of all types of tax treaty disputes. Improving the effectiveness of the operation of the MAP and, equally importantly, ensuring that the cases involved in the MAP process will come to a satisfactory conclusion is the focus of this OECD project.

13. To take forward this project, the OECD formed a Working Group charged with examining ways of improving the effectiveness of the MAP, including the consideration of other dispute resolution techniques such as arbitration. The following describes some of the achievements of this on-going project.

### *Information on countries' competent authorities and MAP process*

14. One of the key messages that emerged from the consultation with business that was done at the beginning of this project was the need to improve the transparency of the MAP process. As a first step in improving transparency, the OECD has made available to the public, via its website, so-called "country profiles" on the mutual agreement procedure of all OECD and some non-OECD countries.<sup>1</sup> These "country profiles" contain information about the competent authorities' contact details, domestic guidelines for MAP and other useful information both for tax authorities and taxpayers. The OECD is hoping to make available similar information for other non-OECD economies and encourages them to provide their profiles to the Secretariat. .

### *July 2004 Progress Report*

15. In July 2004, the Working Group made public a progress report<sup>2</sup> that describes various proposals for improving the resolution of tax treaty disputes.

16. These proposals cover both operational issues and substantive issues arising at different stage of the mutual agreement procedure. Operational issues include topics such as: the transparency of the procedures; the role of the taxpayer in the process; the cost of the process; establishing a timeframe for settlement etc. Substantive issues include: the scope and purpose of Article 25; the interaction between MAP and domestic law; constraints on the ability to use or implement the MAP; time limits, suspension of tax and interest etc. Selected issues are analyzed in detail and proposals are made for improvements in the dispute resolution process. One of the proposals is the development of a Manual on Effective Mutual Agreement

---

1 These country profiles, last updated on 16 September 2005, are available through: [http://www.oecd.org/document/31/0,2340,en\\_2649\\_33747\\_29601439\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/31/0,2340,en_2649_33747_29601439_1_1_1_1,00.html)  
 2 The progress report is available at <http://www.oecd.org/dataoecd/44/6/33629447.pdf>

(MEMAP) that provides information and best practices related to mutual agreement procedure to both tax administrations and taxpayers.

17. The proposals also deal with ways to ensure that the MAP process will reach a satisfactory conclusion and that the conclusion is reached within a reasonable timeframe. Under the existing MAP, if after the end of discussions, the countries involved in a dispute cannot agree, the dispute remains unresolved and can result in unrelieved double taxation. Also, even if an agreement is reached, the procedure can sometimes take a long time and involves a lot of taxpayer and tax administration resources. Such results are unsatisfactory to all concerned. The progress report therefore proposed to examine a number of supplementary techniques, ranging from an advisory opinion to a more formal arbitration process.

*Work after the June 2004 Progress Report*

18. After the release of the June 2004 progress report, the OECD Working Group continued its work based on these proposals. At its June 2005 meeting, it examined a new paragraph which could be added to Article 25 of the OECD Model to provide for arbitration of MAP cases that are still unresolved two years after having been presented to the competent authorities. The mode of application of that arbitration process would be determined by the competent authorities.

19. If the OECD approves the addition of that paragraph to the OECD Model, it would be accompanied by a footnote clarifying that countries that cannot adopt an arbitration process for various reasons remain free not to include the proposed paragraph in their conventions. It would also be accompanied by a detailed Commentary that would discuss the various practical aspects of an arbitration process (e.g. form of the request, terms of reference, selection of arbitrators, communication of information and confidentiality, procedural and evidentiary rules, taxpayer's participation, practical arrangements, costs, applicable legal principles, implementation of the decision, publication of the decision, relationship with domestic law legal remedies etc.)

20. The OECD Working Group will be meeting on 13-16 December 2005 to continue its work on these proposals. It is expected that a document for public consultation will be released in the early part of 2006 and that a public consultation meeting will be held in March 2006 so that a report can be finalized at the end of 2006.

### **III. Discussion of arbitration at the last meeting of the Ad Hoc Group of Experts**

21. The issue of arbitration was briefly discussed at the December 2003 meeting of the Ad Hoc Group of Experts. The following is the summary of these discussions that appears in the Secretary-General's Report on the meeting (note E/2004/51)

"42. Various business groups, including the International Chamber of Commerce, have been promoting the inclusion of an arbitration provision in tax treaties. They contend that such a provision would provide assurance that tax disputes would be resolved in a timely fashion. An arbitration provision may be binding or discretionary. The business community has tended to favour binding arbitration, whereas many Governments have been unwilling to surrender their power to set tax rules to an outside authority. The experience

within the European Union is that the arbitration provision of tax treaties is almost never invoked. The claim is made, nevertheless, that the existence of an arbitration provision tends to promote prompt settlements. No data were available to show whether settlements were being made more promptly as a result of an arbitration provision or whether the decisions made under the threat of arbitration were appropriate ones.

43. Many developed and developing countries are sceptical about the merits of including an arbitration provision in the United Nations Model Convention. It was suggested that the Group of Experts had more pressing matters to address. A concern was expressed that a developing country might be put at a disadvantage in an arbitration proceeding because its resources and expertise may be much less than those at the command of a developed country on the opposite side of an arbitration process. It was estimated that an arbitration event would cost €50,000, a very significant sum for the tax departments of many countries.

44. Arbitration might be an attractive option if it could be implemented at low cost and resulted in prompt and fair decisions. It would be undesirable if it imposed heavy costs or if the threat of arbitration resulted in hasty, ill-considered settlements. The proponents of arbitration have assumed that arbitrators would be neutral and competent and that arbitrators could be supplied when a country did not have the resources to engage an arbitrator. Whether these assumptions are warranted is far from clear."

22. The main conclusions that can be derived from the discussions by the Ad Hoc Group of Experts are:

- there is strong business support for the inclusion of arbitration provisions in tax treaties;
- whilst business tend to support binding arbitration, many governments are concerned about "surrender[ing] their power to set tax rules to an outside authority";
- there are concerns that a developing country might be put at a disadvantage in an arbitration proceeding because its resources and expertise may be much less than those at the command of a developed country on the opposite side of an arbitration process;
- arbitration might be an attractive option if it could be implemented at low cost and resulted in prompt and fair decisions; it would be undesirable if it imposed heavy costs or if the threat of arbitration resulted in hasty, ill-considered settlements.

#### **IV. Options for future work**

23. The Committee should determine whether and how the issue of arbitration and, more generally, dispute resolution should be dealt with in the UN Model.

24. At a minimum, there is a room for improving the practical application of the mutual agreement procedure. In many countries, the contact details of the competent authorities and the process to be followed to bring forward a mutual agreement case are not well known. Guidance could be provided on the typical

organization of the competent authority functions. Work could also be undertaken to analyse time limitations and other domestic law requirements which sometimes prevent an agreement in the context of a mutual agreement procedure. The OECD work on these topics could be useful for these purposes.

25. An attempt could also be made to design an arbitration mechanism adapted to the relations between developed and developing countries. If costs and resources are indeed a major obstacle for developing countries, one could explore a simplified "last-best-offer" type of arbitration where a single arbitrator would simply be asked to choose between the written positions of each competent authority on each unresolved issue without the need for formal meetings of an arbitral panel.

26. Also, if the loss of tax sovereignty remains a concern, one could envisage a process under which once an arbitration decision is rendered, each competent authority is allowed to reject it (pressure by the taxpayers and other competent authorities would probably be sufficient to ensure that this power would not be used routinely).

27. The Committee could also assist by maintaining a list of qualified tax treaty experts who would be familiar with the circumstances of developing countries and could act as independent arbitrators. It could also assist in trying to arrange funding for the costs incurred by developing countries in dealing with arbitration requests; one possible option would be for the taxpayers to bear some of these costs as they would be the main beneficiaries of an arbitration process.

28. These are not an exhaustive list of possible options. Arbitration can be designed in many different ways to ensure that the concerns of most countries are met. What is needed, however, is clear indication that countries agree that tax treaty disputes must not remain unresolved.

---