United Nations E/C.18/2010/CRP.2

Distr.: General
6 October 2010

Original: English

Committee of Experts on International Cooperation in Tax Matters
Sixth Session
Geneva, 18-22 October 2010
Item 3 (b) of the provisional agenda:
Dispute Resolution

Report by the Subcommittee on Dispute Resolution: Arbitration as an Additional Mechanism to improve the mutual Agreement Procedure*

Summary

At its 2009 meeting, the Subcommittee on Dispute Resolution was mandated to consider possibilities to provide for arbitration in the UN Model Tax Convention, either in Article 25 (Mutual Agreement Procedure) itself or, as an alternative, in the Commentary on that Article. In this respect both mandatory and voluntary arbitration shall be considered as well as streamlined arbitration. This note has been prepared by the Subcommittee pursuant to that mandate.

The Subcommittee has concluded that in view of the expected release of a new version of the UN Model in 2011 and the fact that the UN Model already refers to the possibility of adding an arbitration provision to a bilateral treaty (see paragraph 36 of the Commentary on Article 25), the first question to be addressed by the Committee at its 2010 meeting would be where the possible arbitration provision should appear in the UN Model. Several options for doing this are identified in this paper and the UN Tax Committee is asked to decide which of these three options should be followed in the preparation of the revised UN Model.

* This report should not be taken as necessarily representing the views of the United Nations.

ARBITRATION AS AN ADDITIONAL MECHANISM TO IMPROVE THE MUTUAL AGREEMENT PROCEDURE[1]

Introduction

1. At its 2008 meeting, the Committee could not decide whether it was appropriate or not to include a provision on arbitration in Article 25 of the UN Model Convention but agreed that *"a strong recommendation should be made to the next membership of the Committee that improving the mutual agreement procedures and addressing the possibilities for arbitration (either in the United Nations Model Convention or as an alternative provision to it) was an important work*"[2].

2. At its 2009 meeting, the Subcommittee on Dispute Resolution was mandated to consider possibilities to provide for arbitration in the UN Model Tax Convention, either in Article 25 (Mutual Agreement Procedure) itself or, as an alternative, in the Commentary on that Article. In this respect the mandate provides that both mandatory and voluntary arbitration shall be considered as well as streamlined arbitration.

3. This note has been prepared by the Subcommittee pursuant to that mandate. The Subcommittee has concluded that in view of the expected release of a new version of the UN Model in 2011 and the fact that the UN Model already refers to the possibility of adding an arbitration provision to a bilateral treaty (see paragraph 36 of the Commentary on Article 25), the first question to be addressed by the Committee at its 2010 meeting would be where the possible arbitration provision should appear in the UN Model. The following three options were identified by the Subcommittee and it was agreed that the Committee should first be asked to decide, on the basis of this note, which of these three options should be followed in the preparation of the revised UN Model:

Option I: To include an arbitration provision in Article 25 of the UN Model together with a footnote indicating that the contracting states, for a variety of reasons, may consider that the inclusion of the provision is not appropriate.

Option II: To include two alternative versions of Article 25 in the UN Model (as is already done for Articles 8, 18 and 23). Alternative A would not include an arbitration provision while Alternative B would include an arbitration provision similar to the one proposed under Option I.

Option III: To refrain from including an arbitration provision in Article 25 of the UN Model but to include in paragraph 36 of the Commentary on that Article a new optional provision similar to the one proposed under Option I together with optional voluntary arbitration and additional explanations.

All three options expressly let each State free to decide if it is appropriate or not to include a mandatory arbitration provision in its double tax treaties.

4. Section 1 of this note first describes each of these options in greater detail whereas **Annexes 1, 2 and 3** include tentative redrafts of Article 25 and its Commentary under each of these options. Section 2 presents the various arguments in favour and against the inclusion of an arbitration provision in a bilateral treaty, which were

[1] Based on contributions submitted by the following members of the subcommittee on Dispute Resolution: Kwame Adjei-Djan, Hubertus Bierlaagh, Mukesh Butani, Claudine Devillet, Mustapha Kharbouch, Wolfgang Lasars, Carlos E. Protto, Jacques Sasseville and Theo Schmit.

[2] Paragraph 68 of the Report of the Tax Committee's Fourth Annual Session (E/C.18/2008/6).

raised by members of the Subcommittee in the course of the work on this issue. **Annex 4** includes a list of arbitration provisions currently found in tax treaties; **Annex 5** includes examples of arbitration provisions currently found in bilateral social security agreements and bilateral investment treaties; **Annex 6** includes statistics on the Mutual Agreement Procedure collected by the Subcommittee and **Annex 7** describes how the issue of arbitrators' fees has been dealt with under the EU Arbitration Convention and the Belgium - United States tax treaty.

Section 1 – Description of the three options

Option I: Inclusion of an arbitration provision in Article 25 of the UN Model (see also Annex 1)

5. Under this option, the following new paragraph 5 and footnote to that paragraph would be added to Article 25 of the UN Model:

> *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 <u>three years</u> 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 <u>if either competent authority so requests and the person who has presented the case is notified of the request</u>. 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. The arbitration decision shall be binding on both States and shall be implemented notwithstanding any time limits in the domestic laws of those States <u>unless both competent authorities agree on a different solution within six months after the arbitration decision has been communicated to them</u> or unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.*[1]
>
> *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, this 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 the Commentary on this paragraph.*

6. This provision is based on paragraph 5 of Article 25 of the OECD Model. However, it departs from the OECD provision on three points:

- A case may only be submitted to arbitration where the competent authorities are unable to reach an agreement to resolve the case within three years (instead of two years under the OECD provision).
- The arbitration provision may only be triggered by a competent authority and not by the person who has presented the MAP case to the competent authority of a Contracting State. If both competent authorities consider that a case is not suitable for arbitration, the case shall therefore not be submitted

to arbitration. A similar process is provided for in several DTAs concluded by the Netherlands with developing countries (see Annex 4).

- Within six months after the decision has been communicated to them, the competent authorities may conclude a mutual agreement which departs from the arbitration decision. Consequently, if the arbitration decision does not satisfy both competent authorities, those authorities have a last opportunity to agree on a different solution as long as such solution complies with the treaty provisions.

7. The footnote, which is similar to the footnote to paragraph 5 of Article 25 of the OECD Model, indicates that it may not be appropriate to include this provision in a bilateral treaty because of various considerations based on the national law, policy or administration of some States.

8. The Commentary discusses various aspects of the application of this provision and offers alternative provisions that States may prefer to use.

Option II: Inclusion of two alternative versions of Article 25 in the UN Model (see also Annex 2)

9. Under Option II, two alternative versions of Article 25 would be included in the UN Model. This follows the example of what is currently done in the case of Articles 8 (Shipping, Inland Waterways Transport and Air Transport), 18 (Pensions and Social Security Payments) and 23 (Exemption Method and Credit Method). Alternative A of the Article would contain no arbitration provision while Alternative B would contain an arbitration provision similar to the one proposed under Option I.

10. As the alternative of not including the arbitration provision in a bilateral treaty appears as a separate version of the Article, there is no need for a footnote similar to that included in Option I above because of various considerations based on national law, policy or administration of some States. The suggested Commentary on Alternative B discusses various aspects of the application of that provision and offers alternative provisions that States may prefer to use.

Option III: No arbitration provision in Article 25 of the UN Model (see also Annex 3)

11. Under Option III, no provision on arbitration would be included in Article 25 of the UN Model. A new optional provision similar to the one proposed under Option I would be included in paragraph 36 of the Commentary on that Article together with optional voluntary arbitration.

Section 2 - Pros and Cons of adding Mandatory Arbitration to the Mutual Agreement Procedure

1. Necessity of arbitration

12. In the light of the growth of the international economy in the past decades the number of applications for a Mutual Agreement Procedure (MAP) is very small: millions of cross-border transactions every year on the one hand and only a few hundreds of MAPs on the other hand. The number of unsolved MAPs is even smaller.

13. The information supplied by twenty participants to the Tax Committee's Fifth Annual Session indicates that a large majority of MAP cases arise between OECD countries (see Annex 6). As some cases may have been reported twice, it is however not possible to determine a precise percentage of cases involving a non-OECD country (cases between two OECD countries or two non-OECD countries having completed the questionnaire are counted twice).

14. With respect to the average period of time between opening and closing of a MAP case, there is a significant difference between what has been reported by non-OECD countries (13.5 months for MAPs with OECD countries and 8.89 months with non-OECD countries) and what has been reported by OECD countries (more than 28 months with both OECD and non-OECD countries)[3]. Finally, the answers received indicate that a small percentage of MAP cases remain unsolved (8.76% of the cases reported by OECD countries and 12.12% of the cases reported by non-OECD countries).

Against arbitration:

15. One might conclude from that information (huge number of international transactions, small number of MAPs and even smaller number of unsolved MAPs) that DTAs in general and MAPs in particular are quite effective and that mandatory arbitration is not needed. The idea of a 100% success is not realistic in legal reality (e.g. the unsatisfactory results of international administrative assistance based on international agreements, the difficulties into obtaining a timely refund of taxes from a foreign State in some cases and, in other areas, the huge number of unsolved criminal cases or the difficulties encountered by business partners to enforce private contracts). Moreover, the effectiveness of the MAP could still be enhanced through a better treatment of various issues that arise in the course of a MAP (see the draft Guide to the MAP[4] under tax treaties).

In favour of arbitration:

16. One might conclude from the same information that MAP is not as effective as it should be. As around 10% of the cases remain unsolved, the MAP fails in providing foreign investors with full certainty that there will be no taxation contrary to the convention (taxation contrary to treaty provisions might cause the bankruptcy of a company). The legal certainty provided by tax conventions may be jeopardized even if the number of unsolved cases is negligible: any domestic judicial system failing to provide for a solution in 10% of the cases would be considered as seriously flawed. Consequently, arbitration is needed to provide the necessary certainty favouring cross-frontier investments.

17. Moreover, the experience of the EU States under the EU Arbitration Convention[5] shows that it is only recently that those States have taken measures in order to improve MAP. The adoption of such measures was mainly due to the obligation to submit unsolved cases to arbitration after a given period of time and to the fact that EU States prefer to solve MAP cases by themselves before having to go for arbitration. Mandatory arbitration is apparently a powerful incentive facilitating the endeavours of the competent authorities to reach an agreement.

2. Sovereignty as a barrier to arbitration

18. In the international context, the concept of sovereignty refers to all matters within the domestic jurisdiction of a State, in respect of which that State may under international law decide and act independently without intrusions of other sovereign States. These matters include fiscal rules, social security regimes and the treatment of foreign investments.

19. A counterpart of sovereign independence is the capacity and the right of a State to limit its own sovereignty by treaties. In double tax treaties, the Contracting States - under certain conditions - voluntarily limit their sovereign taxation rights on income and capital arising in their own territory. Under investment promotion and protection agreements, the investors of a Contracting State are granted national treatment in the territory of the other Contracting State. Under social security agreements, an employee temporarily present in another

[3] Only six non-OECD countries have responded to the questionnaire.

[4] This will be provided as a separate paper (*Secretariat Note*).

[5] The European Union's multilateral Arbitration Convention (the EU Arbitration Convention) has provided, since January 1, 1995, for mandatory arbitration in transfer pricing MAP cases.

country continues to contribute to his home country social security and is exempt from contributing to the social security of the host country. A lot of those agreements provide for arbitration in order to solve disputes between the Contracting States (see Annexes 4 and 5). The Subcommittee has, consequently, concluded that sovereignty does not prevent States from agreeing in a tax convention to be bound by the decision of an arbitration board (private tax experts) where their competent authorities cannot reach an agreement on a tax issue.

20. The Subcommittee has also concluded that the main question is not whether sovereign States may give up parts of their sovereign rights but why they should do so in tax matters. In this respect, it should be determined if it is in the public interest of a State to provide for mandatory arbitration in its double tax conventions.

Against arbitration:

21. One of the main concerns may be that the interests of States could hardly be safeguarded by private arbitrators in tax matters, which are so fundamental to their public policy. Taxes being the lifeblood of the State itself, States should be particularly reluctant to give up their tax sovereignty and to be bound by the decisions of private tax experts. The interests of States can better be safeguarded if their tax administration can be scrutinised only by their administrative or judicial courts or by their competent authorities.

In favour of arbitration:

22. Certainty is an important aspect of a State's tax policy and a tax treaty is a mean of providing such certainty to taxpayers and of improving the general investment climate in both Contracting States. States should therefore be concerned that unsolved tax disputes may deter investors from entering the country. The lifeblood of taxes could no longer flow if economic life was hindered by the threat of taxation not in accordance with tax treaties. In this respect, it is in the interest of the Contracting States to include in a tax treaty an arbitration provision contributing to its aim of avoiding double taxation.

3. National law as a barrier to arbitration

23. Domestic law (especially constitutional law) may not allow arbitrators to decide on tax issues. However, it should generally not be the case as far as the proposed arbitration provision is concerned (see section 1). Under this provision, the arbitration decision is implemented by a mutual agreement. The arbitration procedure is thus a mere extension of the MAP. The agreement implementing an arbitration decision has the same effect, and the same status for the application of domestic law (especially constitutional law), as agreements reached under the traditional MAP process. Under the proposed provision, the arbitration decision is a binding advice to the competent authorities, unless they agree on a different solution after getting that advice. Formally, the competent authorities are the ones that conclude the mutual agreement. The arbitrators intervene to break the deadlock in which the authorities found themselves after three years of consultations.

24. However, a minority view expressed in the Subcommittee considers that, as the arbitrators may actually dictate a decision upon the competent authorities, it is not convincing to describe arbitration as a tool to ensure that the competent authorities will be able to reach an agreed solution. According to this minority view, mandatory arbitration is more an alternative dispute resolution technique in which private tax experts review a case and impose a decision that is legally binding for both competent authorities unless they can reach a different agreement.

25. A mutual agreement should normally be compatible with domestic law.

26. In some States, where a decision on issues submitted to MAP has already been rendered by one of their courts or administrative tribunals, a mutual agreement on the same issues is no longer allowed under domestic law. To take this situation into account, the proposed provision states that 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 State. States that have the possibility in individual cases to deviate from court decisions in favour of the taxpayer may delete that sentence.

27. The constitutional law of other States provides that no one can be deprived from the judicial remedies available under domestic law. Therefore, the proposed arbitration provision applies irrespective of the remedies provided by the domestic law of the Contracting States and the persons involved in a case have the possibility to reject the mutual agreement implementing the arbitration decision and to pursue the domestic remedies suspended during the arbitration process.

28. Some countries, such as Morocco, have inserted in their domestic law a provision forbidding the submission of tax disputes to arbitration[6]. Such domestic provisions reflect the general policy of a State which considers that arbitration is not justified in tax matters[7].

29. In order to take into consideration various difficulties some States may have, a footnote has been added, under Option I, to the arbitration provision. This footnote is similar to the OECD footnote indicating that it may not be appropriate to include the provision in a bilateral treaty because of considerations based on the national law, policy or administration of some States.

4. Domestic legal remedies

30. Besides a MAP a taxpayer can pursue domestic legal remedies (such as court or administrative appeals) in one or both of the Contracting States in order to have his case solved.

In favour of arbitration:

31. It may be argued that domestic remedies cannot solve adequately and rapidly disputes concerning the application of bilateral conventions.

32. When taxation not in accordance with the convention arises from an incorrect application of the convention in both States, taxpayers have to litigate in each State, with all the difficulties entailed by such a situation and with the risk of inconsistent court decisions. Even where an incorrect application of the convention occurs in only one State, the situation remains difficult and uncertain as courts may adopt a unilateral interpretation of the convention, mainly based on domestic law, rather than the bilateral interpretation required by the MAP.

33. Many taxpayers initiate a MAP while simultaneously initiating domestic relief procedures as authorised under paragraph 1 of Article 25 of the UN Model Tax Convention. However, a taxpayer may rely solely on MAP and not lodge a “protective” appeal under domestic law. Of course, in such situation, if the case cannot be solved under the MAP it cannot either be fully or even partially resolved afterwards under a domestic procedure.[8]

Against arbitration:

34. It may be argued that domestic legal remedies can solve the few cases that the competent authorities are not able to solve through MAP and that a supplementary mechanism such as arbitration is not necessary.
If a taxpayer relies solely on MAP and does not use the legal remedies offered by domestic law, it is not the domestic law‘s fault if the taxpayer has to bear a fiscal burden.

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6 Article 244 du Code général des impôts marocain : « Nonobstant toutes dispositions contraires :
- les litiges relatifs à l’application de la loi fiscale ne peuvent faire l’objet d’arbitrage. »

7 As, under the proposed provision, the competent authorities formally conclude the mutual agreement based on the arbitration decision, it could be argued that the internal law does not legally prohibit a State from agreeing the proposed arbitration provision.

8 Some States deny the taxpayer the ability to initiate the MAP before having renounced the domestic remedies. In such situation, if the case cannot be solved under the MAP, it remains unsolved. Such practice is prohibited by Article 25 of the UN Model.

5. Costs of arbitration

35. The costs associated with the arbitration process may include, but are not limited to:

- costs related to each competent authority's participation in the arbitration proceedings (for example, travel costs and costs related to the preparation and presentation of the competent authority's views);
- arbitrators' fees and travel costs;
- costs incurred in connection with the facilities used to conduct the arbitration proceedings, including telecommunications costs and the costs of secretarial and administrative services;
- other miscellaneous costs, including the costs of translating and/or recording the proceedings.

36. The determination of the arbitrators' remuneration is left to the discretion of the Contracting States. The fees should be in an amount appropriate to ensure that qualified experts will be willing to serve on arbitration board (see Annex 7).

In favour of arbitration:

37. One may consider that those costs are not too heavy and should be borne in order to solve a MAP case.

38. As the effective recourse to arbitration would be rather unusual, the costs relating to that mechanism would be rather low compared to the overall costs relating to dispute resolution (for instance, under the EU Arbitration Convention, only two cases have effectively been submitted to arbitration between the entry into force of the Convention on 1 January 1995 and October 2010).

39. In addition, by guaranteeing a resolution under MAP, arbitration would reduce the number of "protective" appeals and of uncertain domestic proceedings, which are costly and time-consuming for both taxpayers and tax administrations. In this respect, the salaries of judges and their administrative staff should be taken into consideration. Even if those costs do not specifically relate to the concerned cases, those persons devote part of their time to those cases to the detriment of other businesses.

Against arbitration:

40. One may consider that arbitration is too costly and therefore not suitable for developing countries and countries in transition.

41. Arbitration implies additional costs that are not compensated by the decrease in the number of "protective" appeals and domestic proceedings (States have to pay for court buildings, judges' salaries and other functional expenses anyway). In developed countries with expensive lawyers' fees, the cost of these fees in lengthy court proceedings may be huge so that arbitration could be cheaper than domestic proceedings. The situation is however different in developing countries where lawyers' fees are far lower.

42. The competent authority of a developing country could be driven to accept the demands of the other competent authority only because it is reluctant to bear the costs of arbitration. Being unsure of the result of the arbitration process, a competent authority could prefer to give up its taxing rights where the dispute is about moderate amounts rather than take the risk of losing the case and having to support the extra costs of arbitration.

43. As the cost of arbitration is a key difficulty for developing countries, the Subcommittee has discussed some possible ways to reduce that difficulty and invites the Committee to give some guidance for further work in the Subcommittee.

44. One solution could be to provide in the mode of application of the arbitration process that, unless the competent authorities agree in a particular case that the arbitration board will issue an independent decision, the so-called “last best offer” or “final offer” approach (commonly referred to as “baseball arbitration”) will be followed. Such a simplified arbitration process is less costly. It requires only one independent arbitrator, who is expected to make a rather quick choice between the competent authorities’ positions on each question to be resolved through arbitration.

45. The competent authorities could also agree in the mode of application of the arbitration process that a case need not be submitted to arbitration if it does not involve a minimum amount of taxes. Such cases would only be submitted to arbitration if both competent authorities agreed that it is appropriate to do so (e.g. in order to get a principle decision). It would however not be fair to let those cases unsolved. The competent authorities should then correlatively commit themselves to find a solution for all those cases involving a rather limited amount of taxes which would be excluded from the arbitration process.

46. In the context of the UN Model Tax Convention it is sometimes argued that the costs of arbitration proceedings should be borne by taxpayers so as to allow developing countries and countries in transition to give taxpayers access to arbitration despite the additional costs. However, under the proposed UN arbitration provision, arbitration may only be requested by the competent authorities. The Subcommittee therefore feels that it could be inappropriate to make a taxpayer bear the costs of a process which is generally out of his control.

47. Under the OECD arbitration provision, unless otherwise agreed, each competent authority bears its own costs as well as the costs of the arbitrator it has appointed. The third arbitrator’s remuneration as well as travel, telecommunications, and secretariat costs are borne equally by both Contracting States. Costs related to the arbitration board meetings and the required administrative personnel are borne by the competent authority to which the MAP case was initially presented. In the context of the UN Model Tax Convention, countries may consider different methods to share the costs of the arbitration procedure, especially where there is a significant disparity in the level of development of the two Contracting States.

48. The Committee could also discuss:

- the possibility to set up a centre (e.g. in Geneva at the UN) with all the premises and administrative personnel necessary for the conduct of the arbitration process, where the arbitral board could meet; and
- the possible ways to find resources in order to pay the travel expenses of the competent authorities of developing countries as well as the fees of independent arbitrators.

6. Lack of expertise of the Competent Authorities of developing countries

49. Developing countries and countries in transition generally lack field experience as well as material and human resources to deal with MAP cases. Often, there are no specific teams dealing with MAP cases within the tax administration of those countries. Many tax administrations rely on a small number of skilled personnel in charge of all the international taxation issues. Tight budgets prevent many competent authorities from developing some functions, especially those involving translations, training and access to paying data bases.

In favour of arbitration:

50. It may be argued that, to issue a decision, independent arbitrators will examine a case in depth. They will do their best efforts in order to fill in the gaps in the position papers submitted by the competent authorities and will try to achieve a well founded and impartial decision.

51. Consequently, arbitration could be seen as a tool permitting to adjust the levels of expertise of the competent authorities and to overcome the possible lack of experience of some competent authorities and tax administrations.

Against arbitration:

52. It may be argued that, due to the lack of expertise in many developing countries and countries in transition, arbitration would be unfair to those countries when the dispute occurs with more experienced countries. Position papers issued by those countries cannot always be prepared with the appropriate level of detail or presented as strongly as they should be in order to enable the arbitration board to understand their position, take their arguments into consideration and issue an unbiased decision.

53. One may also consider that the arbitrators simply will not have sufficient time to examine a case "in depth" within a period of six months. There are no grounds for assuming that arbitrators will "fill in the gaps in the position papers submitted by the competent authorities". They have no power or means to develop a new chain of evidence. The lack of expertise therefore remains a severe problem.

54. According to the proposed Mutual agreement on arbitration, arbitrators have a period of six months, from the date on which they have received all the information needed to consider a case, to issue a decision. In order to allow them to examine a case more closely, such period could be extended, for instance, to twelve months.

7. Selection of arbitrators

55. It is necessary to have experienced independent and impartial arbitrators from developing countries (and countries in transition) to make sure that the position of those countries will be understood by the arbitration board so that the arbitration process will lead to fair results.

Against arbitration:

56. One may consider that the selection of arbitrators is one of the severe weaknesses of the idea of arbitration in tax matters. The lack of expertise as mentioned in paragraph 44 remains a problem.

57. The other and perhaps more important problem is the question of the neutrality and independence of possible arbitrators. DTAs have two aims vis-à-vis taxpayers and States: to eliminate double taxation and to allocate taxing rights to the States in an equitable manner. Even in the normal procedural law a judge may be disqualified on the grounds of bias. The group of experts in international taxation is quite limited and a great number is biased as is demonstrated through their professional activities or their publications.

In favour of arbitration:

58. Some representatives of developing countries consider that it would not be too difficult to find skilled and experienced arbitrators from developing countries.

59. It is up to the Contracting States to nominate persons eligible to be impartial arbitrators. Experience in the EU shows that people from various backgrounds are listed by the member States: government people, judges, people from academia and practitioners.

60. In order to guarantee their neutrality, the appointed arbitrators could be asked to fill in a statement in which they would declare that, as far as they know, there exist no circumstances that might give rise to justifiable doubts regarding their independence or impartiality and that they will disclose promptly in writing to both competent authorities any such circumstances arising during the course of the arbitration process. Such circumstances include bias, an interest in the result of the arbitration and a past or present relationship with a person directly affected by the case. A competent authority could also have the possibility to challenge any arbitrator whenever justifiable doubts exist as to that arbitrator's impartiality or independence[9].

61. The Subcommittee proposes that the Committee consider:

- the feasibility of finding a sufficient number of neutral, unbiased and independent arbitrators in their respective regions; and
- the possibility of establishing a list of independent tax experts from developing countries, countries in transition and developed countries in order to facilitate the selection of arbitrators. The competent authorities (and the arbitrators) could rely on that list when they feel unable to select an arbitrator in a specific case. If necessary, such list could be updated periodically.

8. Tax planning cases

62. Any economic activity (manufacturing, distribution, sales, treasury, purchasing, warehousing, logistics, etc.) may be "tailored" so as to enable taxpayers to reduce their income tax liability. Some MAP cases are triggered by such "tailor-made tax planning" behaviour of taxpayers. In such cases, the arm's length principle should be leading in establishing the income tax liability in each Contracting State.

63. However, some States consider that cases involving transactions regarded as abusive should not be submitted to arbitration.

64. In order to address that concern, the competent authorities could agree in the mode of application of the arbitration process that a case is not eligible for arbitration where judicial, administrative or other legal proceedings in either Contracting State have resulted in a final ruling that a person directly affected by the case is liable to penalty with respect to fraud, gross negligence or willful default directly related to the case.

65. In any case, in transfer pricing cases, paragraph 3 of Article 9 of the UN Model does not require a Contracting State to make a correlative adjustment where judicial, administrative or other legal proceedings have resulted in a final ruling that an enterprise is liable to penalty with respect to fraud, gross negligence or willful default by reason of the transactions giving rise to the primary adjustment of profits. Those cases will thus be submitted neither to MAP nor to arbitration, except in order to establish the existence or not of the liability to penalty with respect to fraud, gross negligence or willful default.

[9] The competent authority should give written notice of the reasons of the challenge to the other competent authority within one month after the circumstances giving rise to the challenge become known. If the other competent authority would not agree with the challenge, it would be only be effective if for instance the Chair of the Committee agrees that there are justifiable doubts with respect to the independence or impartiality of the arbitrator.

Section 3 - Pros and Cons of adding Voluntary Arbitration to the Mutual Agreement Procedure

66. Under the proposed mandatory arbitration provision, the competent authorities are obliged to submit a case to arbitration if one of them so requests after they were unable to resolve that case within a given period of time. Under a voluntary arbitration provision, in contrast, both competent authorities must agree, on a case by case basis, to submit a case to arbitration before it can proceed to arbitration.

In favour of voluntary arbitration:

67. Voluntary arbitration allows greater control over the types of cases that will 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 inappropriate for the issue to be submitted to arbitration. Under voluntary arbitration countries may demonstrate some commitment to the resolution of tax disputes and at the same time preserve great flexibility as to the issues that will be subjected to arbitration.

68. Voluntary arbitration allows countries to develop familiarity and experience with arbitration without requiring the same sort of commitment that a mandatory arbitration procedure would require. It allows them to restrict the potential number of cases that could proceed to arbitration and to reduce the potential costs of arbitration.

Against voluntary arbitration:

69. Under Article 25 of the UN Model, competent authorities are required to “endeavour to resolve the case by mutual agreement” but are not obliged to reach a solution. This means that the competent authority of one State can render the mutual agreement procedure totally inoperative by systematically refusing to depart from its own interpretations. This is a serious shortcoming of the mutual agreement procedure.

70. Mandatory arbitration, which is triggered by the request of one Contracting State, ensures the final resolution of MAP cases while voluntary arbitration fails to do so. The competent authority of one State can render voluntary arbitration totally inoperative by systematically refusing to submit unresolved cases to arbitration. Voluntary arbitration presents the same shortcoming as the mutual agreement procedure and is therefore largely useless.

71. Under voluntary arbitration, where both States decide to submit a specific case to arbitration, they will face the difficulties of arbitration without having generally provided taxpayers with more certainty and improved the general investment climate.

Conclusion

72. Sections 2 and 3 of this paper have identified the major pros and cons that could induce a State to include mandatory arbitration, voluntary arbitration or no arbitration in its double tax treaties. Having examined those pros and cons, a State could adopt two different approaches.

73. The first approach would be to consider that bilateral relations result in a limited number of tax disputes, that most of them are solved through the MAP (or through internal remedies) and that, consequently, it is not worthwhile to face the difficulties inherent to arbitration in order to solve a negligible number of unsolved cases. States adopting that approach would tend to think that it is not in their interest to be bound by the decisions of

private experts, to bear supplementary costs and to take the risk of losing taxing rights, just in order to solve those few cases. They would therefore conclude that it is not in their interest to include an arbitration provision in their tax treaties.

74. States adopting the second approach would also consider that bilateral relations result in a limited number of tax disputes but, even though most of them are solved through the MAP (or through internal remedies), they would be of the opinion that it is worthwhile facing the difficulties inherent to arbitration in order to reach a solution for the negligible number of unsolved cases. Those States would think that it is in their interest to solve those few cases even at the risk of being bound by the decisions of private experts, bearing supplementary costs and taking the risk of losing taxing rights. They would consider that it is in their interest to give taxpayers more certainty, to send a positive signal to foreign investors and to improve the general investment climate through an arbitration provision.

75. The Committee is invited to examine the different pros and cons identified with respect to mandatory and voluntary arbitration, and the possible ways to reduce the difficulties inherent to arbitration. Further, the Committee is invited to choose one of the three options proposed in Section 1 and give the Subcommittee the necessary guidance so that it can finalize its work in time for the next update.

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ANNEXES TO "ARBITRATION AS AN ADDITIONAL MECHANISM TO IMPROVE THE MUTUAL AGREEMENT PROCEDURE"

Annexes 1, 2 and 3 include tentative redrafts of Article 25 and its Commentary under each of the three options that are presented in the document on Arbitration. Each Annex includes a complete Commentary on Article 25, including the paragraphs dealing with the provisions of Article 25 which do not relate to arbitration. Article 25 and its whole Commentary have to be considered in view of the next Update of the UN Model Double Tax Convention.

Annex 4 includes a list of arbitration provisions currently found in tax treaties.

Annex 5 includes examples of arbitration provisions currently found in bilateral social security agreements and bilateral investment treaties.

Annex 6 includes statistics on the Mutual Agreement Procedure collected by the Subcommittee.

Annex 7 describes how the issue of arbitrators' fees has been dealt with under the EU Arbitration Convention and the Belgium - United States tax treaty.

ANNEX 1

DRAFT ARTICLE AND COMMENTARY UNDER OPTION I

The following is the text of Article 25 and its Commentary that the Subcommittee proposes if the Committee selects Option I (under which Article 25 of the UN Model would be amended through the inclusion of an arbitration provision together with a footnote indicating that the Contracting States, for a variety of reasons, may consider that the inclusion of the provision is not appropriate). All changes to the existing text of the UN Model as well as some comments and questions from the Subcommittee appear in redline.

Article 25

MUTUAL AGREEMENT PROCEDURE

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

> ***Note from the Subcommittee****: The Subcommittee discussed whether paragraph 1 should be amended to allow the case to be presented to either State, as discussed in paragraph 19 of the OECD Commentary quoted in paragraph 4 of the Commentary below. It was unable to reach agreement on whether or not that change should be made and invites the Committee to discuss the proposal*.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The 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.

4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, may develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this article. In addition, a competent authority may devise appropriate unilateral procedures, conditions, methods and techniques to facilitate the above-mentioned bilateral actions and the implementation of the mutual agreement procedure.

***Note from the Subcommittee**: An alternative would be delete the last two sentences, which do not seem to be used in practice, The Subcommittee also notes that a requirement similar to the one in the penultimate sentence is included in Articles 10, 11 and 12 and does not seem, in many cases, to be complied with in practice.*

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 three 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 either competent authority so requests and the person who has presented the case is notified of the request. 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. The arbitration decision shall be binding on both States and shall be implemented notwithstanding any time limits in the domestic laws of these States unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.[1]

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 the Commentary on the paragraph.

COMMENTARY

Article 25

MUTUAL AGREEMENT PROCEDURE

***Note from the Subcommittee**: The revision of the Commentary would also need to take account of any additional changes that could be made to the Article.*

A. GENERAL CONSIDERATIONS

1. Article 25 of the United Nations Model Convention reproduces Article 25 of the OECD Model Convention with one substantive change, namely, the addition of the second and third sentences in paragraph 4.

2. The mutual agreement procedure is designed not only to furnish a means of settling questions relating to the interpretation and application of the Convention, but also to provide (*a*) a forum in which residents of the States involved can seek redress for actions not in accordance with the Convention and (*b*) a mechanism for eliminating double taxation in cases not provided for in the Convention. The mutual agreement procedure applies in connection with all articles of the Convention, and, in particular, to article 7 on business profits, article 9 on associated enterprises, article 11 on interest, article 12 on royalties and article 23 on methods for the elimination of double taxation.

3. In some countries, however, constitutional or legal impediments may restrict the ability of the competent authorities to provide relief, in certain cases, through the mutual agreement procedure. Treaty negotiators should discuss any such impediments that they are aware of. They should also ensure that the scope of paragraph 5, which provides for mandatory arbitration, is restricted in order to avoid the situation where a binding arbitration decision could not be implemented because of such impediments. These impediments do not, however, require a restriction of the scope of the other paragraphs of the Article: the requirement, in paragraphs 2 and 3, that competent authorities "shall endeavour" to resolve cases does not entail an obligation to reach an agreement and, if arbitration is not available, a competent authority is not required to reach a mutual agreement or provide relief.

B. COMMENTARY ON THE PARAGRAPHS OF ARTICLE 25

Paragraphs 1 and 2

4. These paragraphs reproduce the full text of paragraphs 1 and 2 of Article 25 of the OECD Model Convention. As regards the last sentence of paragraph 1, however, the Committee noted that, in bilateral negotiations, States may wish to agree on a different time limit for the presentation of the case to the competent authority of a Contracting State.

5. The following part of the Commentary on Article 25, paragraphs 1 and 2, of the OECD Model Convention (as it read on 22 October 2010) is applicable to the interpretation of these paragraphs:

> [7.] The rules laid down in paragraphs 1 and 2 provide for the elimination in a particular case of taxation which does not accord with the Convention. As is known, in such cases it is normally open to taxpayers to litigate in the tax court, either immediately or upon the dismissal of their objections by the taxation authorities. When taxation not in accordance with the Convention arises from an incorrect application of the Convention in both States, taxpayers are then obliged to litigate in each State, with all the disadvantages and uncertainties that such a situation entails. So paragraph 1 makes available to taxpayers affected, without depriving them of the ordinary legal remedies available, a procedure which is called the mutual agreement procedure because it is aimed, in its second stage, at resolving the dispute on an agreed basis, i.e. by agreement between competent authorities, the first stage being conducted exclusively in the State of residence (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national) from the presentation of the objection up to the decision taken regarding it by the competent authority on the matter.
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> [8.] In any case, the mutual agreement procedure is clearly a special procedure outside the domestic law. It follows that it can be set in motion solely in cases coming within paragraph 1, i.e. cases where tax has been charged, or is going to be charged, in disregard of the provisions of the Convention. So where a charge of tax has been made contrary both to the Convention and the domestic law, this case is amenable to the mutual agreement procedure to the extent only that the Convention is affected, unless a connecting link exists between the rules of the Convention and the rules of the domestic law which have been misapplied.
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> [9.] In practice, the procedure applies to cases by far the most numerous where the measure in question leads to double taxation which it is the specific purpose of the Convention to avoid. Among the most common cases, mention must be made of the following:

— the questions relating to attribution to a permanent establishment of a proportion of the executive and general administrative expenses incurred by the enterprise, under paragraph 3 of Article 7;

— the taxation in the State of the payer in case of a special relationship between the payer and the beneficial owner of the excess part of interest and royalties, under the provisions of Article 9, paragraph 6 of Article 11 or paragraph 4 of Article 12[10];

— cases of application of legislation to deal with thin capitalisation when the State of the debtor company has treated interest as dividends, insofar as such treatment is based on clauses of a convention corresponding for example to Article 9 or paragraph 6 of Article 11;

— cases where lack of information as to the taxpayer's actual situation has led to misapplication of the Convention, especially in regard to the determination of residence (paragraph 2 of Article 4), the existence of a permanent establishment (Article 5), or the temporary nature of the services performed by an employee (paragraph 2 of Article 15).

[10.] Article 25 also provides machinery to enable competent authorities to consult with each other with a view to resolving, in the context of transfer pricing problems, not only problems of juridical double taxation but also those of economic double taxation, and especially those resulting from the inclusion of profits of associated enterprises under paragraph 1 of Article 9; the corresponding adjustments to be made in pursuance of paragraph 2 of the same Article thus fall within the scope of the mutual agreement procedure, both as concerns assessing whether they are well-founded and for determining their amount.

[11.] 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.

[12.] Whilst 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. Whilst 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.

[13.] The mutual agreement procedure is also applicable in the absence of any double taxation contrary to the Convention, once the taxation in dispute is in direct contravention of a rule in the Convention. Such is the case when one State taxes a particular class of income in respect of which the Convention gives an

[10] [Corresponds to paragraph 6 of Article 12 in the UN Model.]

exclusive right to tax to the other State even though the latter is unable to exercise it owing to a gap in its domestic laws. Another category of cases concerns persons who, being nationals of one Contracting State but residents of the other State, are subjected in that other State to taxation treatment which is discriminatory under the provisions of paragraph 1 of Article 24.

[14.] 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.

[15.] 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.

[16.] To be admissible objections presented under paragraph 1 must first meet a twofold requirement expressly formulated in that paragraph: in principle, they must be presented to the competent authority of the taxpayer's State of residence (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national), and they must be so presented within three years of the first notification of the action which gives rise to taxation which is not in accordance with the Convention. The Convention does not lay down any special rule as to the form of the

objections. The competent authorities may prescribe special procedures which they feel to be appropriate. If no special procedure has been specified, the objections may be presented in the same way as objections regarding taxes are presented to the tax authorities of the State concerned.

[17.] The requirement laid on the taxpayer to present his case to the competent authority of the State of which he is a resident (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national) is of general application, regardless of whether the taxation objected to has been charged in that or the other State and regardless of whether it has given rise to double taxation or not. If the taxpayer should have transferred his residence to the other Contracting State subsequently to the measure or taxation objected to, he must nevertheless still present his objection to the competent authority of the State of which he was a resident during the year in respect of which such taxation has been or is going to be charged.

[18.] However, in the case already alluded to where a person who is a national of one State but a resident of the other complains of having been subjected in that other State to an action or taxation which is discriminatory under paragraph 1 of Article 24, it appears more appropriate for obvious reasons to allow him, by way of exception to the general rule set forth above, to present his objection to the competent authority of the Contracting State of which he is a national. Finally, it is to the same competent authority that an objection has to be presented by a person who, while not being a resident of a Contracting State, is a national of a Contracting State, and whose case comes under paragraph 1 of Article 24.

[19.] On the other hand, Contracting States may, if they consider it preferable, give taxpayers the option of presenting their cases to the competent authority of either State. In such a case, paragraph 1 would have to be modified as follows:

> "1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of either Contracting State. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention."

[20.] The time limit of three years set by the second sentence of paragraph 1 for presenting objections is intended to protect administrations against late objections. This time limit must be regarded as a minimum, so that Contracting States are left free to agree in their bilateral conventions upon a longer period in the interests of taxpayers, e.g. on the analogy in particular of the time limits laid down by their respective domestic regulations in regard to tax conventions. Contracting States may omit the second sentence of paragraph 1 if they concur that their respective domestic regulations apply automatically to such objections and are more favourable in their effects to the taxpayers affected, either because they allow a longer time for presenting objections or because they do not set any time limits for such purpose.

[21.] 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. 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, whilst 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 examples of such a situation given in paragraph 14 above).

[22.] 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.

[23.] 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.

[24.] 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. Where it is the combination of decisions or actions taken in both Contracting States that results in taxation not in accordance with the Convention, 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.

[25.] 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 whilst 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 42 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.

[26.] 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 the following paragraphs 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 the mutual agreement procedure. The circumstances in which a State would deny access to the mutual agreement procedure should be made clear in the Convention.

[27.] 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.

[28.] 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 whilst 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.

[29.] 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.

[30.] As regards the procedure itself, it is necessary to consider briefly the two distinct stages into which it is divided (cf. paragraph 7 above).

[31.] In the first stage, which opens with the presentation of the taxpayer’s objections, the procedure takes place exclusively at the level of dealings between him and the competent authorities of his State of residence (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national). The provisions of paragraph 1 give the taxpayer concerned the right to apply to the competent authority of the State of which he is a resident, whether or not he has exhausted all the remedies available to him under the domestic law of each of the two States. On the other hand, that competent authority is under an obligation to consider whether the objection is justified and, if it appears to be justified, take action on it in one of the two forms provided for in paragraph 2.

[32.] If the competent authority duly approached recognises that the complaint is justified and considers that the taxation complained of is due wholly or in part to a measure taken in the taxpayer’s State of

residence, it must give the complainant satisfaction as speedily as possible by making such adjustments or allowing such reliefs as appear to be justified. In this situation, the issue can be resolved without resort to the mutual agreement procedure. On the other hand, it may be found useful to exchange views and information with the competent authority of the other Contracting State, in order, for example, to confirm a given interpretation of the Convention.

[33.] If, however, it appears to that competent authority that the taxation complained of is due wholly or in part to a measure taken in the other State, it will be incumbent on it, indeed it will be its duty — as clearly appears by the terms of paragraph 2 — to set in motion the mutual agreement procedure proper. It is important that the authority in question carry out this duty as quickly as possible, especially in cases where the profits of associated enterprises have been adjusted as a result of transfer pricing adjustments.

[34.] A taxpayer is entitled to present his case under paragraph 1 to the competent authority of the State of which he is a resident whether or not he may also have made a claim or commenced litigation under the domestic law of that State. If litigation is pending, the competent authority of the State of residence should not wait for the final adjudication, but should say whether it considers the case to be eligible for the mutual agreement procedure. If it so decides, it has to determine whether it is itself able to arrive at a satisfactory solution or whether the case has to be submitted to the competent authority of the other Contracting State. An application by a taxpayer to set the mutual agreement procedure in motion should not be rejected without good reason.

[35.] If a claim has been finally adjudicated by a court in the State of residence, a taxpayer may wish even so to present or pursue a claim under the mutual agreement procedure. In some States, the competent authority may be able to arrive at a satisfactory solution which departs from the court decision. In other States, the competent authority is bound by the court decision. It may nevertheless present the case to the competent authority of the other Contracting State and ask the latter to take measures for avoiding double taxation.

[36.] In its second stage - which opens with the approach to the competent authority of the other State by the competent authority to which the taxpayer has applied the procedure is henceforward at the level of dealings between States, as if, so to speak, the State to which the complaint was presented had given it its backing. But whilst this procedure is indisputably a procedure between States, it may, on the other hand, be asked:

— whether, as the title of the Article and the terms employed in the first sentence of paragraph 2 suggest, it is no more than a simple procedure of mutual agreement, or constitutes the implementation of a *pactum de contrahendo* laying on the parties a mere duty to negotiate but in no way laying on them a duty to reach agreement;

— or whether on the contrary, it is to be regarded (based on the existence of the arbitration process provided for in paragraph 5 to address unresolved issues or on the assumption that the procedure takes place within the framework of a joint commission) as a procedure of a jurisdictional nature laying on the parties a duty to resolve the dispute.

[37.] Paragraph 2 no doubt entails a duty to negotiate; but as far as reaching mutual agreement through the procedure is concerned, the competent authorities are under a duty merely to use their best endeavours and not to achieve a result. Paragraph 5, however, provides a mechanism that will allow an agreement to be reached even if there are issues on which the competent authorities have been unable to reach agreement through negotiations.

[38.] In seeking a mutual agreement, the competent authorities must first, of course, determine their position in the light of the rules of their respective taxation laws and of the provisions of the Convention, which are as binding on them as much as they are on the taxpayer. Should the strict application of such rules or provisions preclude any agreement, it may reasonably be held that the competent authorities, as in the case of international arbitration, can, subsidiarily, have regard to considerations of equity in order to give the taxpayer satisfaction.

[39.] The purpose of the last sentence of paragraph 2 is to enable countries with time limits relating to adjustments of assessments and tax refunds in their domestic law to give effect to an agreement despite such time limits. This provision does not prevent, however, such States as are not, on constitutional or other legal grounds, able to overrule the time limits in the domestic law from inserting in the mutual agreement itself such time limits as are adapted to their internal statute of limitation. In certain extreme cases, a Contracting State may prefer not to enter into a mutual agreement, the implementation of which would require that the internal statute of limitation had to be disregarded. Apart from time limits there may exist other obstacles such as “final court decisions” to giving effect to an agreement. Contracting States are free to agree on firm provisions for the removal of such obstacles. As regards the practical implementation of the procedure, it is generally recommended that every effort should be made by tax administrations to ensure that as far as possible the mutual agreement procedure is not in any case frustrated by operational delays or, where time limits would be in point, by the combined effects of time limits and operational delays.

[40.] The Committee on Fiscal Affairs made a number of recommendations on the problems raised by corresponding adjustments of profits following transfer pricing adjustments (implementation of paragraphs 1 and 2 of Article 9) and of the difficulties of applying the mutual agreement procedure to such situations:

a) Tax authorities should notify taxpayers as soon as possible of their intention to make a transfer pricing adjustment (and, where the date of any such notification may be important, to ensure that a clear formal notification is given as soon as possible), since it is particularly useful to ensure as early and as full contacts as possible on all relevant matters between tax authorities and taxpayers within the same jurisdiction and, across national frontiers, between the associated enterprises and tax authorities concerned.

b) Competent authorities should communicate with each other in these matters in as flexible a manner as possible, whether in writing, by telephone, or by face-to-face or round-the-table discussion, whichever is most suitable, and should seek to develop the most effective ways of solving relevant problems. Use of the provisions of Article 26 on the exchange of information should be encouraged in order to assist the competent authority in having well-developed factual information on which a decision can be made.

c) In the course of mutual agreement proceedings on transfer pricing matters, the taxpayers concerned should be given every reasonable opportunity to present the relevant facts and arguments to the competent authorities both in writing and orally.

[41.] As regards the mutual agreement procedure in general, the Committee recommended that:

a) The formalities involved in instituting and operating the mutual agreement procedure should be kept to a minimum and any unnecessary formalities eliminated.

b) Mutual agreement cases should each be settled on their individual merits and not by reference to any balance of the results in other cases.

c) Competent authorities should, where appropriate, formulate and publicise domestic rules, guidelines and procedures concerning use of the mutual agreement procedure.

[42.] 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 that suit. 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 whilst 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.

[43.] 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.

[44.] 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.

[45.] 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, necessary to take into account the concern of a particular competent authority to avoid any divergences or contradictions between the decision of the court and the mutual agreement that is being sought, with the difficulties or risks of abuse that these could entail. In short, therefore, 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 the suit at law concerning those points settled in the mutual agreement.

[46]. 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 14 above) and in the acceptance that there is clearly no such requirement for a procedure initiated by a competent authority under paragraph 3.

[47.] 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 the 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.

[48.] 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.

[49.] 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.

Paragraph 3

6. This paragraph reproduces Article 25, paragraph 3, of the OECD Model Convention. The following part of the OECD Commentary (as it read on 22 October 2010) is therefore applicable to the interpretation of the paragraph:

[50.] The first sentence of this paragraph invites and authorises the competent authorities to resolve, if possible, difficulties of interpretation or application by means of mutual agreement. These are essentially difficulties of a general nature which concern, or which may concern, a category of taxpayers, even if they have arisen in connection with an individual case normally coming under the procedure defined in paragraphs 1 and 2.

[51.] This provision makes it possible to resolve difficulties arising from the application of the Convention. Such difficulties are not only those of a practical nature, which might arise in connection with the setting up and operation of procedures for the relief from tax deducted from dividends, interest and royalties in the Contracting State in which they arise, but also those which could impair or impede the normal operation of the clauses of the Convention as they were conceived by the negotiators, the solution of which does not depend on a prior agreement as to the interpretation of the Convention.

[52.] Under this provision the competent authorities can, in particular:

— where a term has been incompletely or ambiguously defined in the Convention, complete or clarify its definition in order to obviate any difficulty;

— where the laws of a State have been changed without impairing the balance or affecting the substance of the Convention, settle any difficulties that may emerge from the new system of taxation arising out of such changes;

— determine whether, and if so under what conditions, interest may be treated as dividends under thin capitalisation rules in the country of the borrower and give rise to relief for double taxation in the country of residence of the lender in the same way as for dividends (for example relief under a parent/subsidiary regime when provision for such relief is made in the relevant bilateral convention).

[53.] Paragraph 3 confers on the "competent authorities of the Contracting States", i.e. generally the Ministers of Finance or their authorised representatives normally responsible for the administration of the Convention, authority to resolve by mutual agreement any difficulties arising as to the interpretation of the Convention. However, it is important not to lose sight of the fact that, depending on the domestic law of Contracting States, other authorities (Ministry of Foreign Affairs, courts) have the right to interpret international treaties and agreements as well as the "competent authority" designated in the Convention, and that this is sometimes the exclusive right of such other authorities.

[54.] Mutual agreements resolving general difficulties of interpretation or application are binding on administrations as long as the competent authorities do not agree to modify or rescind the mutual agreement.

[55.] 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 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 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 these situations the Convention could be complemented by a protocol 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.

Paragraph 4

7. This paragraph consists of three sentences, the first of which reproduces the first sentence of Article 25, paragraph 4, of the OECD Model Convention, while the second and third sentences are not contained in that Model. In the first sentence, the words "including through a joint commission consisting of themselves or their representatives" have been inserted in 1999 between the words "with each other directly" and ". . . for the purpose of reaching", so as to bring the provision on a par with that of the corresponding provision in the OECD Model Convention. The following part of the OECD Commentary (as it read on 22 October 2010) is applicable to the interpretation of the first sentence of the paragraph:

[56.] This paragraph determines how the competent authorities may consult together for the resolution by mutual agreement, either of an individual case coming under the procedure defined in paragraphs 1 and 2 or of general problems relating in particular to the interpretation or application of the Convention, and which are referred to in paragraph 3.

[57.] It provides first that the competent authorities may communicate with each other directly. It would therefore not be necessary to go through diplomatic channels.

[58.] The competent authorities may communicate with each other by letter, facsimile transmission, telephone, direct meetings, or any other convenient means. They may, if they wish, formally establish a joint commission for this purpose.

[59.] As to this joint commission, paragraph 4 leaves it to the competent authorities of the Contracting States to determine the number of members and the rules of procedure of this body.

[60.] However, whilst the Contracting States may avoid any formalism in this field, it is nevertheless their duty to give taxpayers whose cases are brought before the joint commission under paragraph 2 certain essential guarantees, namely:

— the right to make representations in writing or orally, either in person or through a representative;

— the right to be assisted by counsel.

[61.] However, disclosure to the taxpayer or his representatives of the papers in the case does not seem to be warranted, in view of the special nature of the procedure.

[62.] Without infringing upon the freedom of choice enjoyed in principle by the competent authorities in designating their representatives on the joint commission, it would be desirable for them to agree to entrust the chairmanship of each Delegation — which might include one or more representatives of the service responsible for the procedure — to a high official or judge chosen primarily on account of his special experience; it is reasonable to believe, in fact, that the participation of such persons would be likely to facilitate reaching an agreement.

Note from the Subcommittee: The preceding paragraph 6 has been deleted because:

1) It did not relate to paragraph 4 of the Article.

2) The contents of the second and third subparagraphs (starting with “First” and “Secondly”) were similar to what is already included in paragraph 18 [renumbered 16 below].

3) The last subparagraph was potentially misleading as it is not correct to say that the implementation of the MAP is “delegated to the competent authorities”: the MAP applies regardless of whether or not the competent authorities do anything for its implementation. Also, the meaning of the last sentence, according to which the last sentence of paragraph 1 of Article 25 is made “unnecessary …, except for those countries whose domestic law requires the insertion of the sentence”, was unclear.

Paragraph 5

8. This paragraph reproduces paragraph 5 of Article 25 of the OECD Model Convention with three differences. First, the paragraph provides that arbitration may be initiated if the competent authorities are unable to reach an agreement on a case within three years from the presentation of that case rather than within two years as provided in the OECD Model. Second, while the OECD Model provides that arbitration must be requested by the person who initiated the case, paragraph 5 of the UN Model provides that this must be done by the competent authority of one of the Contracting

States. Finally, paragraph 5 of the UN Model, unlike the corresponding provision of the OECD Model, allows the competent authorities to depart from the arbitration decision if they agree to do so within six months after the decision has been communicated to them.

9. Paragraph 5 provides for mandatory arbitration under which the competent authorities are obliged to submit a case to arbitration if one of them so requests after they were unable to resolve that case within a given period of time. For different reasons, some States consider that it is not appropriate to commit themselves to go for arbitration whenever the competent authority of the other Contracting State so requests. Those States may, however, wish to include in their treaties a voluntary arbitration provision under which both competent authorities must agree, on a case by case basis, to submit a case to arbitration before it can proceed to arbitration. An example of such an additional paragraph could read:

> "If any difficulty or doubt arising as to the interpretation or application of the Convention cannot be resolved by the competent authorities pursuant to the preceding paragraphs of this article, the case may be submitted to arbitration if both competent authorities so agree and, in a specific case, if the person who has presented the case is notified of the request for arbitration. The arbitration decision in a specific case shall be binding on both States with respect to that case and shall be implemented notwithstanding any time limits in the domestic law of those States, unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph."

Where two Contracting States that have not included such paragraph in their Convention wish to implement an arbitration process for general application or to deal with a specific case, it is always possible for them to do so by mutual agreement.

10. Voluntary arbitration allows greater control over the types of cases that will 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 inappropriate for that issue to be submitted to arbitration. Under voluntary arbitration countries preserve great flexibility as to the issues that will be subjected to arbitration and may restrict the potential number of cases that could proceed to arbitration and reduce the potential costs of arbitration.

11. Under voluntary arbitration, however, the competent authority of one State systematically refusing to depart from its own interpretations of the treaty with respect to specific issues may systematically refuse to submit those issues to arbitration. The arbitration of issues on which the competent authorities disagree is essential to ensure that treaty disputes are effectively solved in a consistent manner in both States. Mandatory arbitration ensures the final resolution of such cases while voluntary arbitration fails to do so.

12. The following part of the Commentary on paragraph 5 of Article 25 of the OECD Model Convention, together with its Annex, (as they read on 22 October 2010) is applicable to the interpretation and the application of paragraph 5 (the additional comments that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to reflect the differences described in the previous paragraph):

> [63.] This paragraph provides that, in the cases where the competent authorities are unable to reach an agreement under paragraph 2 within … *[three]* years, the unresolved issues will, at the request of … *[one of the competent authorities]*, be solved through an arbitration process. This process is not dependent on a prior authorization by … *[both]* 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. *[A taxpayer may always request a competent authority to submit a case to arbitration.*

However, the competent authority has no obligation to do so. It has the discretionary power to request arbitration or not in a specific case.]

[64.] 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.

[65.] 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.

[66.] 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.

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

[68.] *[Paragraph 5 allows the]* … 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 26), it is clear that paragraph 5 is not applicable.

[69.] 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 …[*three]* 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 *[either competent authority so requests and the person who has presented the case is notified of the request]*. 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 *[both competent authorities agree on a different solution within six months after the decision has been communicated to them or 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.

[70.] Paragraph 5 provides that *[either competent authority]* …may request that any unresolved issues arising from *[a]* … case be submitted to arbitration *[provided that the person who has presented the case to the competent authority of a Contracting State pursuant to paragraph 1 is notified of that request]*. This request may be made at any time after a period of … *[three]* 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 … *[competent authorities]* … may prefer to wait beyond the end of the …*[three]*-year period (for example, to allow … *[themselves]* 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.

[71.] 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 other competent authority]* cannot request the arbitration of unresolved issues; similarly, the two competent authorities could not consider that the case has been resolved … 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.

[72.] 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 … 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.

[73.] 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 *d*) 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.

[74.] 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.

[75.] The presentation of the case to the competent authority of the other State, which is the beginning of the …*[three]*-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 …*[three]*-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.

[76.] 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, … the arbitration process *[should not be available]* if the *[relevant*] issues … 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 74) and in that case paragraph 5 could be adjusted accordingly.

[77.] 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.

[78.] 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.

[79.] 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.

[80.] 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).

[81.] Paragraph 5 provides that, *[unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or]* 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.

[82.] As noted in subparagraph 76 *b*) 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.

[83.] 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.

[84.] … *[Paragraph 5 allows the competent authorities to agree on a solution that is different from the solution adopted in the arbitration decision provided they do so within six months after the arbitration decision has been communicated to them]* (this, for example, is allowed under Article 12 of the EU Arbitration Convention) [...]

[85.] 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.

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 85 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 *[by one competent authority to the other competent authority and to the person who has presented the case to the competent authority of a Contracting State pursuant to paragraph 1 of Article 25][...]* 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 …*[presented the case]* 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.

2. Time for submission of the case to arbitration

A request for arbitration may only be made after …[*three]* 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 … *[the other competent authority]*, the competent authorities shall agree on the questions to be resolved by the arbitration panel and communicate them in writing to the person who … *[has presented the case]*. 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 …*[,]* within the period referred to in paragraph 3 above, *[the Terms of Reference have not been communicated to the person who has presented the case,]* 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 … *[presented the case]* 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 [...] *[presented the case]*. 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 [...] *[presented the case]* or, where paragraph 4 applies, within four months after the request for arbitration has been received by … *[the other*] competent *authorit[y]*…, 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 …*[Chairperson of the UN Committee of Experts on International Co-operation in Tax Matters, or if the Chairperson is a national or resident of one of the two States involved in the case, by the oldest serving member of that Committee who is not a national or resident of these States. Such appointment shall be made]* within 10 days of receiving a request to that effect from the person who …*[presented the case]*. 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…].

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 …*[presented the case]*, 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 … …*[Chairperson of the UN Committee of Experts on International Co-operation in Tax Matters, or if the Chairperson is a national or resident of one of the two States involved in the case, by the oldest serving member of that Committee who is not a national or resident of these States. Such appointment shall be made]* 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…].

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 …*[three]*-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 …*[sent by one]* 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 …*[presented the case]* 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 … [*presented the case]* 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 … [*another person]* 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 the light of the principles of interpretation incorporated in Articles 31 to 34 of the Vienna Convention on the Law of Treaties … 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 …*[presented the case]* 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 … *[presented the case]* within six months from the date on which the Chair notifies in writing the competent authorities and the person who …*[presented the case]* 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 …*[presented the case]* 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 …*[presented the case]* 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 …*[presented the case]* 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 6 *c*) 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 6 *c*) or 16, they shall appoint a new

arbitrator or arbitrators in accordance with paragraph 5 or 6 *a*), as the case may be.

18. Final decision

The arbitration decision shall be final, *[unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or]* 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

[*Unless both competent authorities agree on a different solution as provided in paragraph 18 above*, *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 …*[presented the case]*, 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 mutual agreement procedure. 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 … *[by one competent authority to the other competent authority and to the person who has presented the case to the competent authority of a Contracting State pursuant to paragraph 1 of Article 25]*.

[6.] In order to determine that the conditions of paragraph 5 of Article 25 have been met (see paragraph 76 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 …[*initiated the mutual agreement procedure]* 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 …*[three]* 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 …*[initiated the mutual agreement procedure]*. 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 …*[initiated the mutual agreement procedure]* (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 …*[Chairperson of the UN Committee of Experts on International Co-operation in Tax Matters, or if the*

Chairperson is a national or resident of one of the two States involved in the case, by the oldest serving member of that Committee who is not a national or resident of these States.] 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 … *[UN Committee of Experts on International Co-operation in Tax Matters]*. 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 …*[three]*-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 …*[who initiated the mutual agreement procedure]*, 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 ,,,*[initiated the mutual agreement procedure],* 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 …*[another person]* 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 the light of the principles

of interpretation incorporated in Articles 31 to 34 of the Vienna Convention on the Law of Treaties. …. 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 a 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 …[*initiated the mutual agreement procedure*] within six months from the date on which the Chair notifies in writing the competent authorities and the person who …[*initiated the mutual agreement procedure*] 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 …[*initiated the mutual agreement procedure*] 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 …[*initiated the mutual agreement procedure*] 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. *[Both competent authorities may, however, agree on a different solution within six months after the decision has been communicated to them].* In order to avoid further delays, it is suggested that the mutual agreement that incorporates the solution arrived at should be completed and 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 *[unless they are able to reach agreement on a different solution]*. Failure to assess taxpayers in accordance with the agreement or to implement the arbitration decision through the conclusion of a mutual agreement *[(unless a different solution has been agreed to)]* 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 *[and within a further period of six months afterwards]*.

C. ADDITIONAL PROCEDURAL ISSUES RELATED TO THE MUTUAL AGREEMENT PROCEDURE

13. The last two sentences of paragraph 4 of Article 25 allow the competent authorities to develop procedures, bilaterally and unilaterally, for the implementation of the mutual agreement procedure. The following discuss various procedural aspects of the mutual agreement procedure and include suggestions concerning procedures that could be adopted by the competent authorities. These suggestions are not exhaustive and should be adapted or supplemented based on the experience and circumstances of each country.

Note from the Subcommittee: The first sentence of this paragraph should be deleted if the last two sentences of paragraph 4 are deleted.

Note from the Subcommittee: Previous paragraph 8 has been deleted as it dealt with the issue of arbitration.

Note from the *Subcommittee:* The previous paragraph 9, which dealt with the interaction between MAP and the GATS, has been moved to the end of the Commentary.

(a) Aspects of the mutual agreement procedure that should be dealt with

14. The procedural arrangements for mutual agreements in general should be suitable to the number and types of issues expected to be dealt with by the competent authorities and to the administrative capability and resources of those authorities. The arrangements should not be rigidly structured but instead should embody the degree of flexibility required to facilitate consultation and agreement rather than hinder them by elaborate procedural requirements and mechanisms. But even relatively simple procedural arrangements must incorporate certain minimum rules that inform taxpayers of their essential rights and obligations under the mutual agreement procedure. Such minimum rules would appear to involve such questions as:

- At what stage in his tax matter a taxpayer can invoke action by the competent authority under the mutual agreement procedure;
- Whether any particular form must be followed by a taxpayer in invoking action by the competent authority;
- Whether any time limits are applicable to a taxpayer's invocation of action by the competent authority;
- If a taxpayer invokes action by the competent authority, whether he is bound by the decision of the competent authorities and whether he must waive recourse to other administrative or judicial processes as a condition for the implementation of a proposed mutual agreement reached by the competent authorities;
- In what manner, if at all, a taxpayer can participate in the competent authority proceedings and what requirements regarding the furnishing of information by a taxpayer are involved.

*(b) Necessary cooperation of the person who makes the request *

15. The successful outcome of the mutual agreement procedure depends to a large extent on the full cooperation of the person who made the request. That person must, in particular, help the competent authorities to establish the facts on which the case is based. That requires the person to make a full and accurate disclosure of all relevant facts and supporting evidence known to that person. Where, in particular, transactions have been carried on in the other Contracting State, the person who made the request must provide the relevant documents establishing the conditions of these transactions and supply complete information on the circumstances of these transactions.

16. The competent authority may require that the person making the request provide the following as early as possible:

- a description of the general background for the case, which would include a description of the business activities of the relevant persons as well as a description of the contracts and arrangements that provide that general background, such as a shareholders' agreement, a partnership agreement, a licence agreement or a

project agreement;

- the details of the situation that allegedly resulted or will result in taxation that is not in accordance with the provisions of the Convention, which could include, for example, the details of transactions or events (e.g. a payment or the delivery of a good or service) that were characterized in a certain way by the tax administration of the other Contracting State, supported by all the relevant documentation and, especially, the documents that have been presented to the tax administration of the other Contracting State;
- the amounts of income and tax involved (or an estimate thereof), the relevant financial statements;
- a description of the relevant taxation years or periods affected by the case (in each State, where these are different);
- a description of the status of the procedure in the other Contracting State, e.g. whether a tax audit report has been produced, a tax assessment received, an appeal filed or litigation undertaken, and
- a reference to the relevant provisions of the applicable tax treaty and the analysis supporting the claim that there is or will be taxation not in accordance with these provisions (when available, the legal analysis of the tax authorities of the other Contracting State should also be provided).

17. It may be more difficult to obtain some of the above information when the relevant transactions involve third parties which are not associated to the person making the request. Also, all that information might not be available at the time the request is made. The information provided at the initial stage should, however, be sufficient to allow the competent authority to which the case is presented to determine whether the objection is justified. A competent authority would not be able to initiate a mutual agreement procedure where the person making the request provides insufficient or inadequate information.

18. The mutual agreement procedure is only available in cases where a person considers that the actions of one or both States result or will result in taxation that is not in accordance with the provisions of the Convention. There may be cases where double taxation will arise because a taxpayer has failed to observe procedural rules (e.g. the expiry of time limits) without there being any taxation contrary to the provision of the Convention; in those cases, the mutual agreement procedure will not be available.

(*c*) *Information on adjustments*

19. The competent authorities should decide on the extent of the information to be provided on adjustments involving income allocation and the time when it is to be given by one competent authority to the other. Thus, the information could cover adjustments proposed or finalized by the tax administration of one country, the related entities involved and the general nature of the adjustments.

20. Generally speaking, most competent authorities are likely to conclude that the automatic transmittal of such information is not needed or desirable. The competent authority of the country making an adjustment may find it difficult or time-consuming to gather the information and prepare it in a suitable form for transmission. In addition, the other competent authority may find it burdensome merely to process a volume of data routinely transmitted by the first competent authority. Moreover, a taxpaying corporation can usually be counted upon to inform its related entity in the other country of the proceedings and the latter is thus in a position to inform, in turn, its competent authority. For this reason, the functioning of a consultation system would be aided if a tax administration considering an adjustment possibly involving an international aspect were to give the taxpayer as much warning as possible.

21. Some competent authorities, while not wishing to be informed routinely of all adjustments in the other country, may desire to receive, either from their own taxpayers or from the other competent authority, “early warning” of serious cases or of the existence of a significant degree or pattern of activity respecting particular types of cases; similarly, they may want to transmit such information. In this event, a process should be worked out for obtaining the

information. Some competent authorities may want to extend this early warning system to less serious cases, thus covering a larger number of cases.

(*d*) *Initiation of competent authority consultation at the point of proposed or finalized adjustments*

22. Paragraph 1 of the Article includes general rules concerning the presentation of a case by the taxpayer. The competent authority to which a case is validly presented must first examine whether it is itself able to arrive at a satisfactory solution. If it is unable to do so, it must determine at what stage it will consult the competent authority of the other State.

23. Many competent authorities, at least in the early stages of their experience, would prefer that the consultation process with the other State not be initiated at the point of a proposed adjustment and probably not even at the point of a finalized adjustment. A proposed adjustment may never result in final action and even a finalized adjustment may or may not trigger a claim for a correlative adjustment; even if it does, the latter adjustment may occur without problems. As a consequence, many competent authorities may decide that the consultation process should not be initiated until the correlative adjustment (or other tax consequence in the second country) is involved at some point.

24. However, some competent authorities prefer that the bilateral process be initiated earlier, perhaps at the proposed adjustment stage. Such involvement may make the process of consultation easier, in that the first country will not have an initial fixed position. In such a case, the other competent authority should be prepared to discuss the case at this early stage with the first competent authority. Other competent authorities may be willing to let the taxpayer decide, and thus stand ready to have the process invoked at any point starting with the proposed adjustment.

25. At a minimum, taxpayers must be informed when they can invoke the mutual agreement procedure and which competent authority is to be addressed. Taxpayers should also be informed in what form the request should be submitted, although it is likely that a simple form would normally be suitable.

(*e*) *Correlative adjustments*

(i) *Governing rule*

Note from the Subcommittee: The preceding three paragraphs have been deleted because they deal with paragraph 2 of Article 9 rather than with the mutual agreement procedure itself. They may, however, be moved to the Commentary on Article 9 if the Committee wants to keep them.

26. It is recognized that, to be effective, a treaty with a correlative adjustment provision based on paragraph 2 of Article 9 must also provide that any domestic law procedural or other barriers to the making of the correlative adjustment are to be disregarded. Thus, such provisions as statutes of limitations and finality of assessments would have to be overridden to permit the correlative adjustment to be made, as required by the last sentence of paragraph 2 of Article 25. If a particular country cannot, through a treaty, override such aspects of its domestic law, this would have to be provided for in the treaty, although it would be hoped that domestic law could be amended to permit the treaty to operate so as to avoid the need for such exceptional provision.

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Note from the Subcommittee: The preceding paragraph is really an introduction to the following paragraph and has therefore been merged with it.

(ii) *Competent authority procedure*

27. Paragraph 2 of Article 9 does not prescribe the method of the correlative adjustment since this depends on the nature of the initial adjustment and its effect on the tax payable on the profits of the associated enterprise. The method of the correlative adjustment is thus an aspect of the substantive issue underlying the initial adjustment. Given the correlative adjustment requirement imposed by Article 9, it is clear that the mutual agreement procedure must be available at this point. Thus, if the tax authorities of the Contracting State that is required to make such an adjustment do not themselves work out the correlative adjustment, the taxpayers should be entitled to invoke the mutual agreement procedure. When a taxpayer invokes the competent authority of a Contracting State, that competent authority may be in a position to dispose of the matter without having to consult the competent authority of the other country, as provided in the first part of paragraph 2 of Article 25. For example, that competent authority may be in a position to handle a matter having potential international consequences that arises from an adjustment proposed by a political subdivision of a State even if the competent authority represents the government of the central government of that State. This is, of course, an aspect of domestic law as affected by the treaty.

28. As a minimum procedural aspect, the competent authorities should indicate the extent to which a taxpayer may be allowed to participate in the competent authority procedure and the manner of his participation. Some countries may wish to favour a reasonable degree of taxpayer participation. Some countries may wish to allow a taxpayer to present information and even to appear before them; others may restrict the taxpayer to the presentation of data. Presumably, the competent authorities would make it a condition that a taxpayer invoking the procedure be required to submit to them relevant information needed to decide the matter. In addition, some competent authorities may, where appropriate, require that data furnished by a taxpayer be prepared as far as possible in accordance with internationally accepted accounting standards so the data provided will have some uniformity and objectivity. It is to be noted that rapid progress is being made in developing international accounting standards and the work of competent authorities should be aided by this development. As a further aspect concerning the taxpayer's participation, there should be a requirement that the taxpayer who invokes the mutual agreement procedure should be informed of the response of the competent authority.

29. The competent authorities will have to decide how their consultation should proceed once that part of the procedure comes into operation. Presumably, the nature of the consultation will depend on the number and character of the cases involved. The competent authorities should keep the consultation procedure flexible and leave every method of communication open, so that the method appropriate to the matter at hand can be used.

30. Various alternatives are available, such as informal consultation by telecommunication or in person; meetings between technical personnel or auditors of each country, whose conclusions are to be accepted or ratified by the competent authorities; appointment of a joint commission for a complicated case or a series of cases; formal meetings of the competent authorities in person etc. It does not seem desirable to place a time limit on when the competent authorities must conclude a matter, since the complexities of particular cases may differ. Nevertheless, competent authorities should develop working habits that are conducive to prompt disposition of cases and should endeavour not to allow undue delay.

31. As discussed in paragraphs 25 and 42 of the OECD Commentary quoted in paragraph 4 above an important minimum procedural aspect of the competent authority procedure is the effect of a taxpayer's invocation of that procedure. Must a taxpayer who invokes that process be bound by the decision of the competent authorities in the sense that he gives up rights to alternative procedures, such as recourse to domestic administrative or judicial procedures? If the competent authorities want their procedure to be exclusive and binding, it would be necessary that the treaty provisions be so drawn as to permit this result. Presumably, this may be accomplished under the general delegation in article 25, paragraph 4, by requiring the taxpayer to waive recourse to those alternative procedures. (However, even with this guideline paragraph, some countries may consider that their domestic law requires a more explicit statement to permit

the competent authority procedure to be binding, especially in view of paragraph 1 of guideline 25[20] referring to remedies under national laws and of the present practice under treaties not to make the procedure a binding one.) Some competent authorities may desire that their actions be binding, since they will not want to go through the effort of reaching agreements only to have the taxpayer reject the result if he feels he can do better in the courts or elsewhere. Other competent authorities may desire to follow the present practice and thus may not want to bind taxpayers or may not be in a position to do so under domestic law. This would appear to be a matter on which developing experience would be a useful guide.

32. A basic issue regarding the competent authority procedure is the extent to which the competent authorities should consider themselves under obligation to reach an agreement on a matter that comes before them. At a minimum, the treaty requires consultation and the obligation to endeavour to find a solution to economic double taxation. But must the consultation end in agreement? Presumably, disagreement would, in general, leave the related entities in a situation where double taxation may result contrary to the treaty, for example, when a country has opposed a correlative adjustment on the grounds that the initial adjustment was not in conformity with the arm's length standard. On the other hand, an agreement would mean a correlative adjustment made, or a change in the initial adjustment followed then by a correlative adjustment, or perhaps the withdrawal of the initial adjustment. In essence, the general question is whether the competent authority consultation is to be governed by the requirement that there be an "agreement to agree".

33. In practice, this question is not as serious as it may seem. The experience of most competent authorities is that in the end an agreement or solution is almost always reached. Of course, the solution may often be a compromise, but compromise is an essential aspect of the process of consultation and negotiation. Hence, in reality, it would not be much of a further step for competent authorities to decide that their procedure should be governed by the standard of "agreement to agree". However, some countries would consider the formal adoption of such standard as a step possessing significant juridical consequences and hence would not be disposed to adopt such a requirement.

34. It is recognized that, for some countries, the process of agreement might well be facilitated if competent authorities, when faced with an extremely difficult case or an impasse, could call, either informally or formally, upon outside experts to give an advisory opinion or otherwise assist in the resolution of the matter. Such experts could be persons currently or previously associated with other tax administrations and possessing the requisite experience in this field. In essence, it would largely be the personal operation of these experts that would be significant. This resort to outside assistance could be useful even where the competent authorities are not operating under the standard of an "agreement to agree", since the outside assistance, by providing a fresh point of view, may help to resolve an impasse.

(*f*) *Publication of competent authority procedures and determinations*

35. The competent authorities should make public the procedures they have adopted with regard to their consultation procedure. The description of the procedures should be as complete as is feasible and at the least should contain the minimum procedural aspects discussed above.

36. Where the consultation procedure has produced a substantive determination in an important area that can reasonably be viewed as providing a guide to the viewpoints of the competent authorities, the competent authorities should develop a procedure for publication in their countries of that determination or decision.

(*g*) *Procedures to implement adjustments*

37. The competent authorities should consider what procedures may be required to implement the various

[20] For any reference to "guideline", please refer to the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (United Nations publication, Sales No. E.79.XVI.3).

adjustments involved. For example:

(i) The first country may consider deferring a tax payment under the adjustment or even waiving the payment if, for example, payment or reimbursement of an expense charge by the associated enterprise is prohibited at the time because of currency or other restrictions imposed by the second country.

(ii) The first country may consider steps to facilitate carrying out the adjustment and payment of a reallocated amount. Thus, if income is imputed and taxed to a parent corporation because of service to a related foreign subsidiary, the related subsidiary may be allowed, as far as the parent country is concerned, to establish on its book an account payable in favour of the parent, and the parent will not be subject to a second tax in its country on the establishment or payment of the amount receivable. Such payment should not be considered a dividend by the country of the subsidiary.

(iii) The second country may consider steps to facilitate carrying out the adjustment and payment of a reallocated amount. This may, for example, involve recognition of the payment made as a deductible item, even though prior to the adjustment there was no legal obligation to pay such amount. This is really an aspect of the correlative adjustment.

(*h*) *Unilateral procedures*

38. The above discussion has related almost entirely to bilateral procedures to be agreed upon by the competent authorities to implement the mutual agreement procedure. In addition, a competent authority may consider it useful to develop certain unilateral rules or procedures involving its relationship to its own taxpayers, so that these relationships may be better understood. These unilateral rules can cover such matters as the form to be followed in bringing matters to the attention of the competent authority; the permission to taxpayers to bring matters to the competent authority at an early stage even where the bilateral procedure does not require consultation at that stage; the question whether the competent authority will raise new domestic issues (so-called affirmative issues) between the tax authorities and the taxpayer if he goes to the competent authority; and requests for information that will assist the competent authority in handling cases.

39. Unilateral rules regarding the operation of a competent authority would not require agreement to them by the other competent authority, since the rules are limited to the domestic relationship with its own taxpayers. However, it would seem appropriate to communicate such unilateral rules to the other treaty competent authorities, and to avoid wherever possible material differences, if any, in such rules in relation to the various treaties.

D. INTERACTION BETWEEN THE MUTUAL AGREMENT PROCEDURE AND THE DISPUTE RESOLUTION MECHANISM OF THE GATS

40. In some rare cases, a dispute between countries concerning the application of the national treatment rule of Article XVII of the General Agreement on Trade in Services (GATS) to taxes covered by a tax treaty could lead to both the MAP and the dispute resolution mechanism of the GATS being applicable to address the issue. This problem, the solution adopted in the GATS with respect to tax treaties that existed at the time that it entered in force and a possible solution with respect to subsequent tax treaties are discussed in the following part of the OECD Commentary (as it read on 22 October 2010), which countries may want to take into account when negotiating a tax treaty:

> [88.] The application of the General Agreement on Trade in Services (GATS), which entered into force on 1 January 1995 and which all member countries have signed, raises particular concerns in relation to the mutual agreement procedure.

[89.] Paragraph 3 of Article XXII of the GATS provides that a dispute as to the application of Article XVII of the Agreement, a national treatment rule, may not be dealt with under the dispute resolution mechanisms provided by Articles XXII and XXIII of the Agreement if the disputed measure "falls within the scope of an international agreement between them relating to the avoidance of double taxation" (e.g. a tax convention). If there is disagreement over whether a measure "falls within the scope" of such an international agreement, paragraph 3 goes on to provide that either State involved in the dispute may bring the matter to the Council on Trade in Services, which shall refer the dispute for binding arbitration. A footnote to paragraph 3, however, contains the important exception that if the dispute relates to an international agreement "which exist[s] at the time of the entry into force" of the Agreement, the matter may not be brought to the Council on Trade in Services unless both States agree.

[90.] That paragraph raises two particular problems with respect to tax treaties.

[91.] First, the footnote thereto provides for the different treatment of tax conventions concluded before and after the entry into force of the GATS, something that may be considered inappropriate, in particular where a convention in existence at the time of the entry into force of the GATS is subsequently renegotiated or where a protocol is concluded after that time in relation to a convention existing at that time.

[92.] Second, the phrase "falls within the scope" is inherently ambiguous, as indicated by the inclusion in paragraph 3 of Article XXII of the GATS of both an arbitration procedure and a clause exempting pre-existing conventions from its application in order to deal with disagreements related to its meaning. Whilst it seems clear that a country could not argue in good faith[11] that a measure relating to a tax to which no provision of a tax convention applied fell within the scope of that convention, it is unclear whether the phrase covers all measures that relate to taxes that are covered by all or only some provisions of the tax convention.

[93.] Contracting States may wish to avoid these difficulties by extending bilaterally the application of the footnote to paragraph 3 of Article XXII of the GATS to conventions concluded after the entry into force of the GATS. Such a bilateral extension, which would supplement but not violate in any way the Contracting States' obligations under the GATS, could be incorporated in the convention by the addition of the following provision:

> "For purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of Article 25 or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States."

[94.] Problems similar to those discussed above may arise in relation with other bilateral or multilateral agreements related to trade or investment. Contracting States are free, in the course of their bilateral negotiations, to amend the provision suggested above so as to ensure that issues relating to the taxes covered by their tax convention are dealt with through the mutual agreement procedure rather than through the dispute settlement mechanism of such agreements.

[11] The obligation of applying and interpreting treaties in good faith is expressly recognized in Articles 26 and 31 of the *Vienna Convention on the Law of Treaties*; thus, the exception in paragraph 3 of Article XXII of the GATS applies only to good faith disputes.

ANNEX 2

DRAFT ARTICLE AND COMMENTARY UNDER OPTION II

The following is the text of Article 25 and its Commentary that the Subcommittee proposes if the Committee selects option II (under which two alternative versions of Article 25 would be included in the UN Model, as is already done for Articles 8, 18 and 23: alternative A would not include an arbitration provision while Alternative B would include an arbitration provision similar to the one proposed under Option I). All changes to the existing text of the UN Model as well as some comments and questions from the Subcommittee appear in redline.

Article 25

MUTUAL AGREEMENT PROCEDURE

Article 25 (alternative A)

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

> ***Note from the Subcommittee****: The Subcommittee discussed whether paragraph 1 should be amended to allow the case to be presented to either State, as discussed in paragraph 19 of the OECD Commentary quoted in paragraph 4 of the Commentary below. It was unable to reach agreement on whether or not that change should be made and invites the Committee to discuss the proposal.*

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The 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.

4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, may develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this article. In addition, a competent authority may devise appropriate unilateral procedures, conditions, methods and techniques to facilitate the above-mentioned bilateral actions and the implementation of the mutual agreement procedure.

***Note from the Subcommittee**: An alternative would be to delete the last two sentences, which do not seem to be used in practice, The Subcommittee also notes that a requirement similar to the one included in the penultimate sentence is included in Articles 10, 11 and 12 and does not seem, in many cases, to be complied with in practice.*

Article 25 (alternative B)

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

***Note from the Subcommittee**: The Subcommittee discussed whether paragraph 1 should be amended to allow the case to be presented to either State, as discussed in paragraph 19 of the OECD Commentary quoted in paragraph 4 of the Commentary below. It was unable to reach agreement on whether or not that change should be made and invites the Committee to discuss the proposal.*

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The 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.

4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, may develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this article. In addition, a competent authority may devise appropriate unilateral procedures, conditions, methods and techniques to facilitate the above-mentioned bilateral actions and the implementation of the mutual agreement procedure.

***Note from the Subcommittee**: An alternative would be to delete the last two sentences, which do not seem to be used in practice, The Subcommittee also notes that a requirement similar to the one included in the penultimate sentence is included in Articles 10, 11 and 12 and does not seem, in many cases, to be complied with in practice.*

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 three 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 either competent authority so requests and the person who has presented the case is notified of the request. 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. The arbitration decision shall be binding on both States and shall be implemented notwithstanding any time limits in the domestic laws of these States unless both competent authorities agree on a different solution which will eliminate the double taxation within six months after the decision has been communicated to them or unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.

COMMENTARY

Article 25

MUTUAL AGREEMENT PROCEDURE

***Note from the Subcommittee**: The revision of the Commentary would also need to take account of any additional changes that could be made to the Article.*

A. GENERAL CONSIDERATIONS

1. Two alternative versions of Article 25 of the United Nations Model Convention are provided. Alternative A reproduces Article 25 of the OECD Model Convention with the addition of a second and third sentences in paragraph 4 but without paragraph 5 of the OECD Model, which deals with the arbitration of issues that would otherwise prevent a mutual agreement. Alternative B reproduces Article 25 of the OECD Model Convention with only one substantive change, namely, the addition of the second and third sentences in paragraph 4.

2. The mutual agreement procedure is designed not only to furnish a means of settling questions relating to the interpretation and application of the Convention, but also to provide (*a*) a forum in which residents of the States involved can seek redress for actions not in accordance with the Convention and (*b*) a mechanism for eliminating double taxation in cases not provided for in the Convention. The mutual agreement procedure applies in connection with all articles of the Convention, and, in particular, to article 7 on business profits, article 9 on associated enterprises, article 11 on interest, article 12 on royalties and article 23 on methods for the elimination of double taxation.

3. In some countries, however, constitutional or legal impediments may restrict the ability of the competent authorities to provide relief, in certain cases, through the mutual agreement procedure. Treaty negotiators should discuss any such impediments that they are aware of. Under Alternative A, the presence of such impediments should not, however, lead to a modification of the Article that would restrict its scope (especially if, in the future, such impediments are removed): the requirement that competent authorities "shall endeavour" to resolve the case does not entail an obligation to reach as solution and acknowledges that certain factors may affect the ability of a competent authority to reach a mutual agreement

or provide relief. Under Alternative B, however, negotiators should ensure that the scope of paragraph 5, which provides for mandatory arbitration, is restricted to take account of these restrictions in order to avoid the situation where a binding arbitration decision could not be implemented because of such impediments.

B. COMMENTARY ON THE PARAGRAPHS OF ARTICLE 25

Paragraphs 1 and 2

4. These paragraphs reproduce the full text of paragraphs 1 and 2 of Article 25 of the OECD Model Convention. As regards the last sentence of paragraph 1, however, the Committee noted that, in bilateral negotiations, States may wish to agree on a different time limit for the presentation of the case to the competent authority of a Contracting State.

5. The following part of the Commentary on Article 25, paragraphs 1 and 2, of the OECD Model Convention (as it read on 22 October 2010) is applicable to the interpretation of these paragraphs:

> [7.] The rules laid down in paragraphs 1 and 2 provide for the elimination in a particular case of taxation which does not accord with the Convention. As is known, in such cases it is normally open to taxpayers to litigate in the tax court, either immediately or upon the dismissal of their objections by the taxation authorities. When taxation not in accordance with the Convention arises from an incorrect application of the Convention in both States, taxpayers are then obliged to litigate in each State, with all the disadvantages and uncertainties that such a situation entails. So paragraph 1 makes available to taxpayers affected, without depriving them of the ordinary legal remedies available, a procedure which is called the mutual agreement procedure because it is aimed, in its second stage, at resolving the dispute on an agreed basis, i.e. by agreement between competent authorities, the first stage being conducted exclusively in the State of residence (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national) from the presentation of the objection up to the decision taken regarding it by the competent authority on the matter.
>
> [8.] In any case, the mutual agreement procedure is clearly a special procedure outside the domestic law. It follows that it can be set in motion solely in cases coming within paragraph 1, i.e. cases where tax has been charged, or is going to be charged, in disregard of the provisions of the Convention. So where a charge of tax has been made contrary both to the Convention and the domestic law, this case is amenable to the mutual agreement procedure to the extent only that the Convention is affected, unless a connecting link exists between the rules of the Convention and the rules of the domestic law which have been misapplied.
>
> [9.] In practice, the procedure applies to cases by far the most numerous where the measure in question leads to double taxation which it is the specific purpose of the Convention to avoid. Among the most common cases, mention must be made of the following:
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> — the questions relating to attribution to a permanent establishment of a proportion of the executive and general administrative expenses incurred by the enterprise, under paragraph 3 of Article 7;
>
> — the taxation in the State of the payer in case of a special relationship between the payer and the beneficial owner of the excess part of interest and royalties, under the provisions of Article 9, paragraph 6 of Article 11 or paragraph 4 of Article 12[12];

[12] [Corresponds to paragraph 6 of Article 12 in the UN Model.]

— cases of application of legislation to deal with thin capitalisation when the State of the debtor company has treated interest as dividends, insofar as such treatment is based on clauses of a convention corresponding for example to Article 9 or paragraph 6 of Article 11;

— cases where lack of information as to the taxpayer's actual situation has led to misapplication of the Convention, especially in regard to the determination of residence (paragraph 2 of Article 4), the existence of a permanent establishment (Article 5), or the temporary nature of the services performed by an employee (paragraph 2 of Article 15).

[10.] Article 25 also provides machinery to enable competent authorities to consult with each other with a view to resolving, in the context of transfer pricing problems, not only problems of juridical double taxation but also those of economic double taxation, and especially those resulting from the inclusion of profits of associated enterprises under paragraph 1 of Article 9; the corresponding adjustments to be made in pursuance of paragraph 2 of the same Article thus fall within the scope of the mutual agreement procedure, both as concerns assessing whether they are well-founded and for determining their amount.

[11.] 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.

[12.] Whilst 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. Whilst 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.

[13.] The mutual agreement procedure is also applicable in the absence of any double taxation contrary to the Convention, once the taxation in dispute is in direct contravention of a rule in the Convention. Such is the case when one State taxes a particular class of income in respect of which the Convention gives an exclusive right to tax to the other State even though the latter is unable to exercise it owing to a gap in its domestic laws. Another category of cases concerns persons who, being nationals of one Contracting State but residents of the other State, are subjected in that other State to taxation treatment which is discriminatory under the provisions of paragraph 1 of Article 24.

[14.] 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.

[15.] 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.[13]

[16.] To be admissible objections presented under paragraph 1 must first meet a twofold requirement expressly formulated in that paragraph: in principle, they must be presented to the competent authority of the taxpayer’s State of residence (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national), and they must be so presented within three years of the first notification of the action which gives rise to taxation which is not in accordance with the Convention. The Convention does not lay down any special rule as to the form of the objections. The competent authorities may prescribe special procedures which they feel to be appropriate. If no special procedure has been specified, the objections may be presented in the same way as objections regarding taxes are presented to the tax authorities of the State concerned.

[17.] The requirement laid on the taxpayer to present his case to the competent authority of the State of which he is a resident (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national) is of general application, regardless of whether the taxation objected to has been charged in that or the other State and regardless of whether it has

[13] This paragraph is only relevant with respect to Alternative B.

given rise to double taxation or not. If the taxpayer should have transferred his residence to the other Contracting State subsequently to the measure or taxation objected to, he must nevertheless still present his objection to the competent authority of the State of which he was a resident during the year in respect of which such taxation has been or is going to be charged.

[18.] However, in the case already alluded to where a person who is a national of one State but a resident of the other complains of having been subjected in that other State to an action or taxation which is discriminatory under paragraph 1 of Article 24, it appears more appropriate for obvious reasons to allow him, by way of exception to the general rule set forth above, to present his objection to the competent authority of the Contracting State of which he is a national. Finally, it is to the same competent authority that an objection has to be presented by a person who, while not being a resident of a Contracting State, is a national of a Contracting State, and whose case comes under paragraph 1 of Article 24.

[19.] On the other hand, Contracting States may, if they consider it preferable, give taxpayers the option of presenting their cases to the competent authority of either State. In such a case, paragraph 1 would have to be modified as follows:

> "1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of either Contracting State. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention."

[20.] The time limit of three years set by the second sentence of paragraph 1 for presenting objections is intended to protect administrations against late objections. This time limit must be regarded as a minimum, so that Contracting States are left free to agree in their bilateral conventions upon a longer period in the interests of taxpayers, e.g. on the analogy in particular of the time limits laid down by their respective domestic regulations in regard to tax conventions. Contracting States may omit the second sentence of paragraph 1 if they concur that their respective domestic regulations apply automatically to such objections and are more favourable in their effects to the taxpayers affected, either because they allow a longer time for presenting objections or because they do not set any time limits for such purpose.

[21.] 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. 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, whilst 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 examples of such a situation given in paragraph 14 above).

[22.] 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.

[23.] 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.

[24.] 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. Where it is the combination of decisions or actions taken in both Contracting States that results in taxation not in accordance with the Convention, 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.

[25.] 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 whilst 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 42 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.

[26.] 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 the following paragraphs 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 the mutual agreement procedure. The circumstances in which a State would deny access to the mutual agreement procedure should be made clear in the Convention.

[27.] 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.

[28.] 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 whilst 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.

[29.] 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.

[30.] As regards the procedure itself, it is necessary to consider briefly the two distinct stages into which it is divided (cf. paragraph 7 above).

[31.] In the first stage, which opens with the presentation of the taxpayer’s objections, the procedure takes place exclusively at the level of dealings between him and the competent authorities of his State of residence (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national). The provisions of paragraph 1 give the taxpayer concerned the right to apply to the competent authority of the State of which he is a resident, whether or not he has exhausted all the remedies available to him under the domestic law of each of the two States. On the other hand, that competent authority is under an obligation to consider whether the objection is justified and, if it appears to be justified, take action on it in one of the two forms provided for in paragraph 2.

[32.] If the competent authority duly approached recognises that the complaint is justified and considers that the taxation complained of is due wholly or in part to a measure taken in the taxpayer’s State of residence, it must give the complainant satisfaction as speedily as possible by making such adjustments or allowing such reliefs as appear to be justified. In this situation, the issue can be resolved without resort to the mutual agreement procedure. On the other hand, it may be found useful to exchange views and information with the competent authority of the other Contracting State, in order, for example, to confirm a given interpretation of the Convention.

[33.] If, however, it appears to that competent authority that the taxation complained of is due wholly or in part to a measure taken in the other State, it will be incumbent on it, indeed it will be its duty — as clearly appears by the terms of paragraph 2 — to set in motion the mutual agreement procedure proper. It

is important that the authority in question carry out this duty as quickly as possible, especially in cases where the profits of associated enterprises have been adjusted as a result of transfer pricing adjustments.

[34.] A taxpayer is entitled to present his case under paragraph 1 to the competent authority of the State of which he is a resident whether or not he may also have made a claim or commenced litigation under the domestic law of that State. If litigation is pending, the competent authority of the State of residence should not wait for the final adjudication, but should say whether it considers the case to be eligible for the mutual agreement procedure. If it so decides, it has to determine whether it is itself able to arrive at a satisfactory solution or whether the case has to be submitted to the competent authority of the other Contracting State. An application by a taxpayer to set the mutual agreement procedure in motion should not be rejected without good reason.

[35.] If a claim has been finally adjudicated by a court in the State of residence, a taxpayer may wish even so to present or pursue a claim under the mutual agreement procedure. In some States, the competent authority may be able to arrive at a satisfactory solution which departs from the court decision. In other States, the competent authority is bound by the court decision. It may nevertheless present the case to the competent authority of the other Contracting State and ask the latter to take measures for avoiding double taxation.

[36.] In its second stage - which opens with the approach to the competent authority of the other State by the competent authority to which the taxpayer has applied the procedure is henceforward at the level of dealings between States, as if, so to speak, the State to which the complaint was presented had given it its backing. But whilst this procedure is indisputably a procedure between States, it may, on the other hand, be asked:

— whether, as the title of the Article and the terms employed in the first sentence of paragraph 2 suggest, it is no more than a simple procedure of mutual agreement, or constitutes the implementation of a *pactum de contrahendo* laying on the parties a mere duty to negotiate but in no way laying on them a duty to reach agreement;

— or whether on the contrary, it is to be regarded (based on the existence of the arbitration process provided for in paragraph 5 to address unresolved issues or[14] on the assumption that the procedure takes place within the framework of a joint commission) as a procedure of a jurisdictional nature laying on the parties a duty to resolve the dispute.

[37.] Paragraph 2 no doubt entails a duty to negotiate; but as far as reaching mutual agreement through the procedure is concerned, the competent authorities are under a duty merely to use their best endeavours and not to achieve a result. Paragraph 5, however, provides a mechanism that will allow an agreement to be reached even if there are issues on which the competent authorities have been unable to reach agreement through negotiations.[15]

[38.] In seeking a mutual agreement, the competent authorities must first, of course, determine their position in the light of the rules of their respective taxation laws and of the provisions of the Convention, which are as binding on them as much as they are on the taxpayer. Should the strict application of such rules or provisions preclude any agreement, it may reasonably be held that the competent authorities, as in the case of international arbitration, can, subsidiarily, have regard to considerations of equity in order to give the taxpayer satisfaction.

[14] The preceding words are only relevant with respect to Alternative B.

[15] The last sentence is only relevant with respect to Alternative B.

[39.] The purpose of the last sentence of paragraph 2 is to enable countries with time limits relating to adjustments of assessments and tax refunds in their domestic law to give effect to an agreement despite such time limits. This provision does not prevent, however, such States as are not, on constitutional or other legal grounds, able to overrule the time limits in the domestic law from inserting in the mutual agreement itself such time limits as are adapted to their internal statute of limitation. In certain extreme cases, a Contracting State may prefer not to enter into a mutual agreement, the implementation of which would require that the internal statute of limitation had to be disregarded. Apart from time limits there may exist other obstacles such as "final court decisions" to giving effect to an agreement. Contracting States are free to agree on firm provisions for the removal of such obstacles. As regards the practical implementation of the procedure, it is generally recommended that every effort should be made by tax administrations to ensure that as far as possible the mutual agreement procedure is not in any case frustrated by operational delays or, where time limits would be in point, by the combined effects of time limits and operational delays.

[40.] The Committee on Fiscal Affairs made a number of recommendations on the problems raised by corresponding adjustments of profits following transfer pricing adjustments (implementation of paragraphs 1 and 2 of Article 9) and of the difficulties of applying the mutual agreement procedure to such situations:

a) Tax authorities should notify taxpayers as soon as possible of their intention to make a transfer pricing adjustment (and, where the date of any such notification may be important, to ensure that a clear formal notification is given as soon as possible), since it is particularly useful to ensure as early and as full contacts as possible on all relevant matters between tax authorities and taxpayers within the same jurisdiction and, across national frontiers, between the associated enterprises and tax authorities concerned.

b) Competent authorities should communicate with each other in these matters in as flexible a manner as possible, whether in writing, by telephone, or by face-to-face or round-the-table discussion, whichever is most suitable, and should seek to develop the most effective ways of solving relevant problems. Use of the provisions of Article 26 on the exchange of information should be encouraged in order to assist the competent authority in having well-developed factual information on which a decision can be made.

c) In the course of mutual agreement proceedings on transfer pricing matters, the taxpayers concerned should be given every reasonable opportunity to present the relevant facts and arguments to the competent authorities both in writing and orally.

[41.] As regards the mutual agreement procedure in general, the Committee recommended that:

a) The formalities involved in instituting and operating the mutual agreement procedure should be kept to a minimum and any unnecessary formalities eliminated.

b) Mutual agreement cases should each be settled on their individual merits and not by reference to any balance of the results in other cases.

c) Competent authorities should, where appropriate, formulate and publicise domestic rules, guidelines and procedures concerning use of the mutual agreement procedure.

[42.] 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 that suit. 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 whilst 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.[16] 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.

[43.] 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.

[44.] 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.

[45.] 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, necessary to take into account the concern of a particular competent authority to avoid any divergences or contradictions between the decision of the court and the mutual agreement that is being sought, with the difficulties or risks of abuse that these could entail. In short, therefore, 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 the suit at law concerning those points settled in the mutual agreement.

[46]. 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

[16] The last sentence is only relevant with respect to Alternative B.

been charged to tax or notified of a liability (as noted at paragraph 14 above) and in the acceptance that there is clearly no such requirement for a procedure initiated by a competent authority under paragraph 3.

[47.] 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 the 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.

[48.] 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.

[49.] 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.

Paragraph 3

6. This paragraph reproduces Article 25, paragraph 3, of the OECD Model Convention. The following part of the OECD Commentary (as it read on 22 October 2010) is therefore applicable to the interpretation of the paragraph:

[50.] The first sentence of this paragraph invites and authorises the competent authorities to resolve, if possible, difficulties of interpretation or application by means of mutual agreement. These are essentially difficulties of a general nature which concern, or which may concern, a category of taxpayers, even if they have arisen in connection with an individual case normally coming under the procedure defined in paragraphs 1 and 2.

[51.] This provision makes it possible to resolve difficulties arising from the application of the Convention. Such difficulties are not only those of a practical nature, which might arise in connection with the setting up and operation of procedures for the relief from tax deducted from dividends, interest and royalties in the Contracting State in which they arise, but also those which could impair or impede the normal operation of the clauses of the Convention as they were conceived by the negotiators, the solution of which does not depend on a prior agreement as to the interpretation of the Convention.

[52.] Under this provision the competent authorities can, in particular:

— where a term has been incompletely or ambiguously defined in the Convention, complete or clarify its definition in order to obviate any difficulty;

— where the laws of a State have been changed without impairing the balance or affecting the substance of the Convention, settle any difficulties that may emerge from the new system of taxation arising out of such changes;

— determine whether, and if so under what conditions, interest may be treated as dividends under thin capitalisation rules in the country of the borrower and give rise to relief for double taxation in the country of residence of the lender in the same way as for dividends (for example relief

under a parent/subsidiary regime when provision for such relief is made in the relevant bilateral convention).

[53.] Paragraph 3 confers on the "competent authorities of the Contracting States", i.e. generally the Ministers of Finance or their authorised representatives normally responsible for the administration of the Convention, authority to resolve by mutual agreement any difficulties arising as to the interpretation of the Convention. However, it is important not to lose sight of the fact that, depending on the domestic law of Contracting States, other authorities (Ministry of Foreign Affairs, courts) have the right to interpret international treaties and agreements as well as the "competent authority" designated in the Convention, and that this is sometimes the exclusive right of such other authorities..

[54.] Mutual agreements resolving general difficulties of interpretation or application are binding on administrations as long as the competent authorities do not agree to modify or rescind the mutual agreement..

[55.] 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 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 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 these situations the Convention could be complemented by a protocol 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.

Paragraph 4

7. This paragraph consists of three sentences, the first of which reproduces the first sentence of Article 25, paragraph 4, of the OECD Model Convention, while the second and third sentences are not contained in that Model. In the first sentence, the words "including through a joint commission consisting of themselves or their representatives" have been inserted in 1999 between the words "with each other directly" and ". . . for the purpose of reaching", so as to bring the provision on a par with that of the corresponding provision in the OECD Model Convention. The following part of the OECD Commentary (as it read on 22 October 2010) is applicable to the interpretation of the first sentence of the paragraph:

[56.] This paragraph determines how the competent authorities may consult together for the resolution by mutual agreement, either of an individual case coming under the procedure defined in paragraphs 1 and 2 or of general problems relating in particular to the interpretation or application of the Convention, and which are referred to in paragraph 3.

[57.] It provides first that the competent authorities may communicate with each other directly. It would therefore not be necessary to go through diplomatic channels.

[58.] The competent authorities may communicate with each other by letter, facsimile transmission, telephone, direct meetings, or any other convenient means. They may, if they wish, formally establish a joint commission for this purpose.

[59.] As to this joint commission, paragraph 4 leaves it to the competent authorities of the Contracting States to determine the number of members and the rules of procedure of this body.

[60.] However, whilst the Contracting States may avoid any formalism in this field, it is nevertheless their duty to give taxpayers whose cases are brought before the joint commission under paragraph 2 certain essential guarantees, namely:

— the right to make representations in writing or orally, either in person or through a representative;

— the right to be assisted by counsel.

[61.] However, disclosure to the taxpayer or his representatives of the papers in the case does not seem to be warranted, in view of the special nature of the procedure.

[62.] Without infringing upon the freedom of choice enjoyed in principle by the competent authorities in designating their representatives on the joint commission, it would be desirable for them to agree to entrust the chairmanship of each Delegation — which might include one or more representatives of the service responsible for the procedure — to a high official or judge chosen primarily on account of his special experience; it is reasonable to believe, in fact, that the participation of such persons would be likely to facilitate reaching an agreement.

Note from the Subcommittee: The preceding paragraph 6 has been deleted because:

1) It did not relate to paragraph 4 of the Article.

2) The contents of the second and third subparagraphs (starting with "First" and "Secondly") were similar to what is already included in paragraph 18 [renumbered 16 below].

3) The last subparagraph was potentially misleading as it is not correct to say that the implementation of the MAP is "delegated to the competent authorities": the MAP applies regardless of whether or not the competent authorities do anything for its implementation. Also, the meaning of the last sentence, according to which the last sentence of paragraph 1 of Article 25 is made "unnecessary …, except for those countries whose domestic law requires the insertion of the sentence", was unclear.

Paragraph 5 Alternative B

8. Paragraph 5, which is only found in Alternative B of the Article, reproduces paragraph 5 of Article 25 of the OECD Model Convention with four differences. First, the paragraph provides that arbitration may be initiated if the competent authorities are unable to reach an agreement on a case within three years from the presentation of that case rather than within two years as provided in the OECD Model. Second, while the OECD Model provides that arbitration must be requested by the person who initiated the case, paragraph 5 of Alternative B provides that this must be done by the competent authority of one of the Contracting States. Third, paragraph 5 of Alternative B, unlike the corresponding provision of the OECD Model, allows the competent authorities to depart from the arbitration decision if they agree to do so within six months after the decision has been communicated to them. Finally, the footnote that is found in the

OECD Model, according to which the inclusion of the provision may not be appropriate in certain circumstances, has been omitted as Alternative A already deals with such situations.

9. Paragraph 5 provides for mandatory arbitration under which the competent authorities are obliged to submit a case to arbitration if one of them so requests after they were unable to resolve that case within a given period of time. For different reasons, some States consider that it is not appropriate to commit themselves to go for arbitration whenever the competent authority of the other Contracting State so requests. Those States may, however, wish to include in their treaties a voluntary arbitration provision under which both competent authorities must agree, on a case by case basis, to submit a case to arbitration before it can proceed to arbitration. An example of such an additional paragraph could read:

> "If any difficulty or doubt arising as to the interpretation or application of the Convention cannot be resolved by the competent authorities pursuant to the preceding paragraphs of this article, the case may be submitted to arbitration if both competent authorities so agree and, in a specific case, if the person who has presented the case is notified of the request for arbitration. The arbitration decision in a specific case shall be binding on both States with respect to that case and shall be implemented notwithstanding any time limits in the domestic law of those States, unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph."

Where two Contracting States that have not included such paragraph in their Convention wish to implement an arbitration process for general application or to deal with a specific case, it is always possible for them to do so by mutual agreement.

10. Voluntary arbitration allows greater control over the types of cases that will 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 inappropriate for that issue to be submitted to arbitration. Under voluntary arbitration countries preserve great flexibility as to the issues that will be subjected to arbitration and may restrict the potential number of cases that could proceed to arbitration and reduce the potential costs of arbitration.

11. Under voluntary arbitration, however, the competent authority of one State systematically refusing to depart from its own interpretations of the treaty with respect to specific issues may systematically refuse to submit those issues to arbitration. The arbitration of issues on which the competent authorities disagree is essential to ensure that treaty disputes are effectively solved in a consistent manner in both States. Mandatory arbitration ensures the final resolution of such cases while voluntary arbitration fails to do so.

12. The following part of the Commentary on paragraph 5 of Article 25 of the OECD Model Convention, together with its Annex, (as they read on 22 October 2010) is applicable to the interpretation and the application of this paragraph (the additional comments that appear in italics between square brackets, which are not part of the Commentary on the OECD Model, have been inserted in order to reflect the differences described in the previous paragraph):

> [63.] This paragraph provides that, in the cases where the competent authorities are unable to reach an agreement under paragraph 2 within … *[three]* years, the unresolved issues will, at the request of … *[one of the competent authorities]*, be solved through an arbitration process. This process is not dependent on a prior authorization by … *[both]* 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. *[A taxpayer may always request a competent authority to submit a case to arbitration.*

However, the competent authority has no obligation to do so. It has the discretionary power to request arbitration or not in a specific case.]

[64.] 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.

[65.] 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.

[66.] 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.

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

[68.] *[Paragraph 5 allows the]* … 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 26), it is clear that paragraph 5 is not applicable.

[69.] 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 …[*three]* 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 … *[either competent authority so requests and the person who has presented the case is notified of the request]*. 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 *[both competent authorities agree on a different solution within six months after the decision has been communicated to them or 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.

[70.] Paragraph 5 provides that *[either competent authority]* …may request that any unresolved issues arising from *[a]* … case be submitted to arbitration *[provided that the person who has presented the case to the competent authority of a Contracting State pursuant to paragraph 1 is notified of that request]*. This request may be made at any time after a period of … *[three]* 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 … *[competent authorities]* … may prefer to wait beyond the end of the …*[three]*-year period (for example, to allow … *[themselves]* 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.

[71.] 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 other competent authority]* cannot request the arbitration of unresolved issues; similarly, the two competent authorities could not consider that the case has been resolved … 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.

[72.] 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 … 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.

[73.] 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 *d*) 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.

[74.] 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.

[75.] The presentation of the case to the competent authority of the other State, which is the beginning of the …*[three]*-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 …*[three]*-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.

[76.] 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, … the arbitration process *[should not be available]* if the *[relevant*] issues … 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 74) and in that case paragraph 5 could be adjusted accordingly.

[77.] 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.

[78.] 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.

[79.] 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.

[80.] 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).

[81.] Paragraph 5 provides that, *[unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or]* 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.

[82.] As noted in subparagraph 76 *b*) 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.

[83.] 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.

[84.] … *[Paragraph 5 allows the competent authorities to agree on a solution that is different from the solution adopted in the arbitration decision provided they do so within six months after the arbitration decision has been communicated to them]* (this, for example, is allowed under Article 12 of the EU Arbitration Convention) [...]

[85.] 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.

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 85 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 *[by one competent authority to the other competent authority and to the person who has presented the case to the competent authority of a Contracting State pursuant to paragraph 1 of Article 25][...]* 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 …*[presented the case]* 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.

2. Time for submission of the case to arbitration

A request for arbitration may only be made after …[*three]* 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 … *[the other competent authority]*, the competent authorities shall agree on the questions to be resolved by the arbitration panel and communicate them in writing to the person who … *[has presented the case]*. 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 …*[,]* within the period referred to in paragraph 3 above, *[the Terms of Reference have not been communicated to the person who has presented the case,]* 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 … *[presented the case]* 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 [...] *[presented the case]*. 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 [...] *[presented the case]* or, where paragraph 4 applies, within four months after the request for arbitration has been received by … *[the other*] competent *authorit[y]*…, 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 …*[Chairperson of the UN Committee of Experts on International Co-operation in Tax Matters, or if the Chairperson is a national or resident of one of the two States involved in the case, by the oldest serving member of that Committee who is not a national or resident of these States. Such appointment shall be made]* within 10 days of receiving a request to that effect from the person who …*[presented the case]*. 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…].

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 …*[presented the case]*, 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 … …*[Chairperson of the UN Committee of Experts on International Co-operation in Tax Matters, or if the Chairperson is a national or resident of one of the two States involved in the case, by the oldest serving member of that Committee who is not a national or resident of these States. Such appointment shall be made]* 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…].

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 …*[three]*-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 …*[sent by one]* 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 …*[presented the case]* 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 … [*presented the case]* 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 … [*another person]* 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 the light of the principles of interpretation incorporated in Articles 31 to 34 of the Vienna Convention on the Law of Treaties. …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 …*[presented the case]* 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 … *[presented the case]* within six months from the date on which the Chair notifies in writing the competent authorities and the person who …*[presented the case]* 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 …*[presented the case]* 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 …*[presented the case]* 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 …*[presented the case]* 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 6 *c*) 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 6 *c*) or 16, they shall appoint a new arbitrator or arbitrators in accordance with paragraph 5 or 6 *a*), as the case may be.

18. Final decision

The arbitration decision shall be final, *[unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or]* 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

[*Unless both competent authorities agree on a different solution as provided in paragraph 18 above*, *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 …*[presented the case]*, 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 mutual agreement procedure. 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 … *[by one competent authority to the other competent authority and to the person who has presented the case to the competent authority of a Contracting State pursuant to paragraph 1 of Article 25]*.

[6.] In order to determine that the conditions of paragraph 5 of Article 25 have been met (see paragraph 76 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 …[*initiated the mutual agreement procedure]* 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 …*[three]* 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 …*[initiated the mutual agreement procedure]*. 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 …*[initiated the mutual agreement procedure]* (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 …*[Chairperson of the UN Committee of Experts on International Co-operation in Tax Matters, or if the Chairperson is a national or resident of one of the two States involved in the case, by the oldest serving member of that Committee who is not a national or resident of these States.]* 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 … *[UN Committee of Experts on International Co-operation in Tax Matters]*. 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 …*[three]*-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 *…[who initiated the mutual agreement procedure]*, 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 ,,,*[initiated the mutual agreement procedure]*, 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 …*[another person]* 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 the light of the principles of interpretation incorporated in Articles 31 to 34 of the Vienna Convention on the Law of Treaties…. 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 a 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 …[*initiated the mutual agreement procedure*] within six months from the date on which the Chair notifies in writing the competent authorities and the person who …[*initiated the mutual agreement procedure*] 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 …[*initiated the mutual agreement procedure*] 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 …[*initiated the mutual agreement procedure*] 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. *[Both competent authorities may, however, agree on a different solution within six months after the decision has been communicated to them].* In order to avoid further delays, it is suggested that the mutual

agreement that incorporates the solution arrived at should be completed and 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 *[unless they are able to reach agreement on a different solution]*. Failure to assess taxpayers in accordance with the agreement or to implement the arbitration decision through the conclusion of a mutual agreement *[(unless a different solution has been agreed to)]* 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 *[and within a further period of six months afterwards]*.

C. ADDITIONAL PROCEDURAL ISSUES RELATED TO THE MUTUAL AGREEMENT PROCEDURE

13. The last two sentences of paragraph 4 of Article 25 allow the competent authorities to develop procedures, bilaterally and unilaterally, for the implementation of the mutual agreement procedure. The following discuss various procedural aspects of the mutual agreement procedure and include suggestions concerning procedures that could be adopted by the competent authorities. These suggestions are not exhaustive and should be adapted or supplemented based on the experience and circumstances of each country.

Note from the Subcommittee: The first sentence of this paragraph should be deleted if the last two sentences of paragraph 4 are deleted.

Note from the Subcommittee: Previous paragraph 8 has been deleted as it dealt with the issue of arbitration.

Note from the Subcommittee: This previous paragraph 9, which dealt with the interaction between MAP and the GATS, has been moved to the end of the Commentary.

(a) Aspects of the mutual agreement procedure that should be dealt with

14. The procedural arrangements for mutual agreements in general should be suitable to the number and types of issues expected to be dealt with by the competent authorities and to the administrative capability and resources of those authorities. The arrangements should not be rigidly structured but instead should embody the degree of flexibility required to facilitate consultation and agreement rather than hinder them by elaborate procedural requirements and mechanisms. But even relatively simple procedural arrangements must incorporate certain minimum rules that

inform taxpayers of their essential rights and obligations under the mutual agreement procedure. Such minimum rules would appear to involve such questions as:

- At what stage in his tax matter a taxpayer can invoke action by the competent authority under the mutual agreement procedure;
- Whether any particular form must be followed by a taxpayer in invoking action by the competent authority;
- Whether any time limits are applicable to a taxpayer's invocation of action by the competent authority;
- If a taxpayer invokes action by the competent authority, whether he is bound by the decision of the competent authorities and whether he must waive recourse to other administrative or judicial processes as a condition for the implementation of a proposed mutual agreement reached by the competent authorities;
- In what manner, if at all, a taxpayer can participate in the competent authority proceedings and what requirements regarding the furnishing of information by a taxpayer are involved.

(b) Necessary cooperation of the person who makes the request

15. The successful outcome of the mutual agreement procedure depends to a large extent on the full cooperation of the person who made the request. That person must, in particular, help the competent authorities to establish the facts on which the case is based. That requires the person to make a full and accurate disclosure of all relevant facts and supporting evidence known to that person. Where, in particular, transactions have been carried on in the other Contracting State, the person who made the request must provide the relevant documents establishing the conditions of these transactions and supply complete information on the circumstances of these transactions.

16 The competent authority may require that the person making the request provide the following as early as possible:

- a description of the general background for the case, which would include a description of the business activities of the relevant persons as well as a description of the contracts and arrangements that provide that general background, such as a shareholders' agreement, a partnership agreement, a licence agreement or a project agreement;
- the details of the situation that allegedly resulted or will result in taxation that is not in accordance with the provisions of the Convention, which could include, for example, the details of transactions or events (e.g. a payment or the delivery of a good or service) that were characterized in a certain way by the tax administration of the other Contracting State, supported by all the relevant documentation and, especially, the documents that have been presented to the tax administration of the other Contracting State;
- the amounts of income and tax involved (or an estimate thereof), the relevant financial statements;
- a description of the relevant taxation years or periods affected by the case (in each State, where these are different);
- a description of the status of the procedure in the other Contracting State, e.g. whether a tax audit report has been produced, a tax assessment received, an appeal filed or litigation undertaken, and
- a reference to the relevant provisions of the applicable tax treaty and the analysis supporting the claim that there is or will be taxation not in accordance with these provisions (when available, the legal analysis of the tax authorities of the other Contracting State should also be provided).

17. It may be more difficult to obtain some of the above information when the relevant transactions involve third

parties which are not associated to the person making the request. Also, all that information might not be available at the time the request is made. The information provided at the initial stage should, however, be sufficient to allow the competent authority to which the case is presented to determine whether the objection is justified.

18. The mutual agreement procedure is only available in cases where a person considers that the actions of one or both States result or will result in taxation that is not in accordance with the provisions of the Convention. There may be cases where double taxation will arise because a taxpayer has failed to observe procedural rules (e.g. the expiry of time limits) without there being any taxation contrary to the provision of the Convention; in those cases, the mutual agreement procedure will not be available.

(*c*) *Information on adjustments*

19. The competent authorities should decide on the extent of the information to be provided on adjustments involving income allocation and the time when it is to be given by one competent authority to the other. Thus, the information could cover adjustments proposed or finalized by the tax administration of one country, the related entities involved and the general nature of the adjustments.

20. Generally speaking, most competent authorities are likely to conclude that the automatic transmittal of such information is not needed or desirable. The competent authority of the country making an adjustment may find it difficult or time-consuming to gather the information and prepare it in a suitable form for transmission. In addition, the other competent authority may find it burdensome merely to process a volume of data routinely transmitted by the first competent authority. Moreover, a taxpaying corporation can usually be counted upon to inform its related entity in the other country of the proceedings and the latter is thus in a position to inform, in turn, its competent authority. For this reason, the functioning of a consultation system would be aided if a tax administration considering an adjustment possibly involving an international aspect were to give the taxpayer as much warning as possible.

21. Some competent authorities, while not wishing to be informed routinely of all adjustments in the other country, may desire to receive, either from their own taxpayers or from the other competent authority, “early warning” of serious cases or of the existence of a significant degree or pattern of activity respecting particular types of cases; similarly, they may want to transmit such information. In this event, a process should be worked out for obtaining the information. Some competent authorities may want to extend this early warning system to less serious cases, thus covering a larger number of cases.

(*d*) *Initiation of competent authority consultation at the point of proposed or finalized adjustments*

22. Paragraph 1 of the Article includes general rules concerning the presentation of a case by the taxpayer. The competent authority to which a case is validly presented must first examine whether it is itself able to arrive at a satisfactory solution. If it is unable to do so, it must determine at what stage it will consult the competent authority of the other State.

23. Many competent authorities, at least in the early stages of their experience, would prefer that the consultation process with the other State not be initiated at the point of a proposed adjustment and probably not even at the point of a finalized adjustment. A proposed adjustment may never result in final action and even a finalized adjustment may or may not trigger a claim for a correlative adjustment; even if it does, the latter adjustment may occur without problems. As a consequence, many competent authorities may decide that the consultation process should not be initiated until the correlative adjustment (or other tax consequence in the second country) is involved at some point.

24. However, some competent authorities prefer that the bilateral process be initiated earlier, perhaps at the proposed adjustment stage. Such involvement may make the process of consultation easier, in that the first country will not

have an initial fixed position. In such a case, the other competent authority should be prepared to discuss the case at this early stage with the first competent authority. Other competent authorities may be willing to let the taxpayer decide, and thus stand ready to have the process invoked at any point starting with the proposed adjustment.

25. At a minimum, taxpayers must be informed when they can invoke the mutual agreement procedure and which competent authority is to be addressed. Taxpayers should also be informed in what form the request should be submitted, although it is likely that a simple form would normally be suitable.

(*e*) *Correlative adjustments*

(i) *Governing rule*

Note from the Subcommittee: The preceding three paragraphs have been deleted because they deal with paragraph 2 of Article 9 rather than with the mutual agreement procedure itself. They may, however, be moved to the Commentary on Article 9 if the Committee wants to keep them.

26. It is recognized that, to be effective, a treaty with a correlative adjustment provision based on paragraph 2 of Article 9 must also provide that any domestic law procedural or other barriers to the making of the correlative adjustment are to be disregarded. Thus, such provisions as statutes of limitations and finality of assessments would have to be overridden to permit the correlative adjustment to be made, as required by the last sentence of paragraph 2 of Article 25. If a particular country cannot, through a treaty, override such aspects of its domestic law, this would have to be provided for in the treaty, although it would be hoped that domestic law could be amended to permit the treaty to operate so as to avoid the need for such exceptional provision.

Note from the Subcommittee: The preceding paragraph is really an introduction to the following paragraph and has therefore been merged with it.

(ii) *Competent authority procedure*

27. Paragraph 2 of Article 9 does not prescribe the method of the correlative adjustment since this depends on the nature of the initial adjustment and its effect on the tax payable on the profits of the associated enterprise. The method of the correlative adjustment is thus an aspect of the substantive issue underlying the initial adjustment. Given the correlative adjustment requirement imposed by Article 9, it is clear that the mutual agreement procedure must be available at this point. Thus, if the tax authorities of the Contracting State that is required to make such an adjustment do not themselves work out the correlative adjustment, the taxpayers should be entitled to invoke the mutual agreement procedure. When a taxpayer invokes the competent authority of a Contracting State, that competent authority may be in a position to dispose of the matter without having to consult the competent authority of the other country, as provided in the first part of paragraph 2 of Article 25. For example, that competent authority may be in a position to handle a matter having potential international consequences that arises from an adjustment proposed by a political subdivision of a State even if the competent authority represents the government of the central government of that State. This is, of course, an aspect of domestic law as affected by the treaty.

28. As a minimum procedural aspect, the competent authorities should indicate the extent to which a taxpayer may be allowed to participate in the competent authority procedure and the manner of his participation. Some countries may wish to favour a reasonable degree of taxpayer participation. Some countries may wish to allow a taxpayer to present

information and even to appear before them; others may restrict the taxpayer to the presentation of data. Presumably, the competent authorities would make it a condition that a taxpayer invoking the procedure be required to submit to them relevant information needed to decide the matter. In addition, some competent authorities may, where appropriate, require that data furnished by a taxpayer be prepared as far as possible in accordance with internationally accepted accounting standards so the data provided will have some uniformity and objectivity. It is to be noted that rapid progress is being made in developing international accounting standards and the work of competent authorities should be aided by this development. As a further aspect concerning the taxpayer's participation, there should be a requirement that the taxpayer who invokes the mutual agreement procedure should be informed of the response of the competent authority.

29. The competent authorities will have to decide how their consultation should proceed once that part of the procedure comes into operation. Presumably, the nature of the consultation will depend on the number and character of the cases involved. The competent authorities should keep the consultation procedure flexible and leave every method of communication open, so that the method appropriate to the matter at hand can be used.

30. Various alternatives are available, such as informal consultation by telecommunication or in person; meetings between technical personnel or auditors of each country, whose conclusions are to be accepted or ratified by the competent authorities; appointment of a joint commission for a complicated case or a series of cases; formal meetings of the competent authorities in person etc. It does not seem desirable to place a time limit on when the competent authorities must conclude a matter, since the complexities of particular cases may differ. Nevertheless, competent authorities should develop working habits that are conducive to prompt disposition of cases and should endeavour not to allow undue delay.

31. As discussed in paragraphs 25 and 42 of the OECD Commentary quoted in paragraph 4 above an important minimum procedural aspect of the competent authority procedure is the effect of a taxpayer's invocation of that procedure. Must a taxpayer who invokes that process be bound by the decision of the competent authorities in the sense that he gives up rights to alternative procedures, such as recourse to domestic administrative or judicial procedures? If the competent authorities want their procedure to be exclusive and binding, it would be necessary that the treaty provisions be so drawn as to permit this result. Presumably, this may be accomplished under the general delegation in article 25, paragraph 4, by requiring the taxpayer to waive recourse to those alternative procedures. (However, even with this guideline paragraph, some countries may consider that their domestic law requires a more explicit statement to permit the competent authority procedure to be binding, especially in view of paragraph 1 of guideline 25[20] referring to remedies under national laws and of the present practice under treaties not to make the procedure a binding one.) Some competent authorities may desire that their actions be binding, since they will not want to go through the effort of reaching agreements only to have the taxpayer reject the result if he feels he can do better in the courts or elsewhere. Other competent authorities may desire to follow the present practice and thus may not want to bind taxpayers or may not be in a position to do so under domestic law. This would appear to be a matter on which developing experience would be a useful guide.

32. A basic issue regarding the competent authority procedure is the extent to which the competent authorities should consider themselves under obligation to reach an agreement on a matter that comes before them. At a minimum, the treaty requires consultation and the obligation to endeavour to find a solution to economic double taxation. But must the consultation end in agreement? Presumably, disagreement would, in general, leave the related entities in a situation where double taxation may result contrary to the treaty, for example, when a country has opposed a correlative adjustment on the grounds that the initial adjustment was not in conformity with the arm's length standard. On the other hand, an agreement would mean a correlative adjustment made, or a change in the initial adjustment followed then by a correlative adjustment, or perhaps the withdrawal of the initial adjustment. In essence, the general question is whether the competent authority consultation is to be governed by the requirement that there be an "agreement to agree".

[20] For any reference to "guideline", please refer to the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (United Nations publication, Sales No. E.79.XVI.3).

33. In practice, this question is not as serious as it may seem. The experience of most competent authorities is that in the end an agreement or solution is almost always reached. Of course, the solution may often be a compromise, but compromise is an essential aspect of the process of consultation and negotiation. Hence, in reality, it would not be much of a further step for competent authorities to decide that their procedure should be governed by the standard of "agreement to agree". However, some countries would consider the formal adoption of such standard as a step possessing significant juridical consequences and hence would not be disposed to adopt such a requirement.

34. It is recognized that, for some countries, the process of agreement might well be facilitated if competent authorities, when faced with an extremely difficult case or an impasse, could call, either informally or formally, upon outside experts to give an advisory opinion or otherwise assist in the resolution of the matter. Such experts could be persons currently or previously associated with other tax administrations and possessing the requisite experience in this field. In essence, it would largely be the personal operation of these experts that would be significant. This resort to outside assistance could be useful even where the competent authorities are not operating under the standard of an "agreement to agree", since the outside assistance, by providing a fresh point of view, may help to resolve an impasse.

(*f*) *Publication of competent authority procedures and determinations*

35. The competent authorities should make public the procedures they have adopted with regard to their consultation procedure. The description of the procedures should be as complete as is feasible and at the least should contain the minimum procedural aspects discussed above.

36. Where the consultation procedure has produced a substantive determination in an important area that can reasonably be viewed as providing a guide to the viewpoints of the competent authorities, the competent authorities should develop a procedure for publication in their countries of that determination or decision.

(*g*) *Procedures to implement adjustments*

37. The competent authorities should consider what procedures may be required to implement the various adjustments involved. For example:

(i) The first country may consider deferring a tax payment under the adjustment or even waiving the payment if, for example, payment or reimbursement of an expense charge by the associated enterprise is prohibited at the time because of currency or other restrictions imposed by the second country.

(ii) The first country may consider steps to facilitate carrying out the adjustment and payment of a reallocated amount. Thus, if income is imputed and taxed to a parent corporation because of service to a related foreign subsidiary, the related subsidiary may be allowed, as far as the parent country is concerned, to establish on its book an account payable in favour of the parent, and the parent will not be subject to a second tax in its country on the establishment or payment of the amount receivable. Such payment should not be considered a dividend by the country of the subsidiary.

(iii) The second country may consider steps to facilitate carrying out the adjustment and payment of a reallocated amount. This may, for example, involve recognition of the payment made as a deductible item, even though prior to the adjustment there was no legal obligation to pay such amount. This is really an aspect of the correlative adjustment.

(*h*) *Unilateral procedures*

38. The above discussion has related almost entirely to bilateral procedures to be agreed upon by the competent authorities to implement the mutual agreement procedure. In addition, a competent authority may consider it useful to

develop certain unilateral rules or procedures involving its relationship to its own taxpayers, so that these relationships may be better understood. These unilateral rules can cover such matters as the form to be followed in bringing matters to the attention of the competent authority; the permission to taxpayers to bring matters to the competent authority at an early stage even where the bilateral procedure does not require consultation at that stage; the question whether the competent authority will raise new domestic issues (so-called affirmative issues) between the tax authorities and the taxpayer if he goes to the competent authority; and requests for information that will assist the competent authority in handling cases.

39. Unilateral rules regarding the operation of a competent authority would not require agreement to them by the other competent authority, since the rules are limited to the domestic relationship with its own taxpayers. However, it would seem appropriate to communicate such unilateral rules to the other treaty competent authorities, and to avoid wherever possible material differences, if any, in such rules in relation to the various treaties.

D. INTERACTION BETWEEN THE MUTUAL AGREMENT PROCEDURE AND THE DISPUTE RESOLUTION MECHANISM OF THE GATS

40. In some rare cases, a dispute between countries concerning the application of the national treatment rule of Article XVII of the General Agreement on Trade in Services (GATS) to taxes covered by a tax treaty could lead to both the MAP and the dispute resolution mechanism of the GATS being applicable to address the issue. This problem, the solution adopted in the GATS with respect to tax treaties that existed at the time that it entered in force and a possible solution with respect to subsequent tax treaties are discussed in the following parts of the OECD Commentary (as it read on 22 October 2010), which countries may want to take into account when negotiating a tax treaty:

> [88.] The application of the General Agreement on Trade in Services (GATS), which entered into force on 1 January 1995 and which all member countries have signed, raises particular concerns in relation to the mutual agreement procedure.
>
> [89.] Paragraph 3 of Article XXII of the GATS provides that a dispute as to the application of Article XVII of the Agreement, a national treatment rule, may not be dealt with under the dispute resolution mechanisms provided by Articles XXII and XXIII of the Agreement if the disputed measure "falls within the scope of an international agreement between them relating to the avoidance of double taxation" (e.g. a tax convention). If there is disagreement over whether a measure "falls within the scope" of such an international agreement, paragraph 3 goes on to provide that either State involved in the dispute may bring the matter to the Council on Trade in Services, which shall refer the dispute for binding arbitration. A footnote to paragraph 3, however, contains the important exception that if the dispute relates to an international agreement "which exist[s] at the time of the entry into force" of the Agreement, the matter may not be brought to the Council on Trade in Services unless both States agree.
>
> [90.] That paragraph raises two particular problems with respect to tax treaties.
>
> [91.] First, the footnote thereto provides for the different treatment of tax conventions concluded before and after the entry into force of the GATS, something that may be considered inappropriate, in particular where a convention in existence at the time of the entry into force of the GATS is subsequently renegotiated or where a protocol is concluded after that time in relation to a convention existing at that time.
>
> [92.] Second, the phrase "falls within the scope" is inherently ambiguous, as indicated by the inclusion in paragraph 3 of Article XXII of the GATS of both an arbitration procedure and a clause exempting pre-existing conventions from its application in order to deal with disagreements related to its meaning. Whilst

it seems clear that a country could not argue in good faith[17] that a measure relating to a tax to which no provision of a tax convention applied fell within the scope of that convention, it is unclear whether the phrase covers all measures that relate to taxes that are covered by all or only some provisions of the tax convention.

[93.] Contracting States may wish to avoid these difficulties by extending bilaterally the application of the footnote to paragraph 3 of Article XXII of the GATS to conventions concluded after the entry into force of the GATS. Such a bilateral extension, which would supplement but not violate in any way the Contracting States' obligations under the GATS, could be incorporated in the convention by the addition of the following provision:

> "For purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of Article 25 or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States."

[94.] Problems similar to those discussed above may arise in relation with other bilateral or multilateral agreements related to trade or investment. Contracting States are free, in the course of their bilateral negotiations, to amend the provision suggested above so as to ensure that issues relating to the taxes covered by their tax convention are dealt with through the mutual agreement procedure rather than through the dispute settlement mechanism of such agreements.

[17] The obligation of applying and interpreting treaties in good faith is expressly recognized in Articles 26 and 31 of the *Vienna Convention on the Law of Treaties*; thus, the exception in paragraph 3 of Article XXII of the GATS applies only to good faith disputes.

ANNEX 3

DRAFT ARTICLE AND COMMENTARY UNDER OPTION III

The following is the text of Article 25 and its Commentary that the Subcommittee proposes if the Committee selects option III (under which Article 25 of the UN Model would not be changed but paragraph 36 of the Commentary would be replaced by a new optional provision similar to the one proposed under Option I). All changes to the existing text of the UN Model as well as some comments and questions from the Subcommittee appear in redline.

Article 25

MUTUAL AGREEMENT PROCEDURE

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

> ***Note from the Subcommittee****: The Subcommittee discussed whether paragraph 1 should be amended to allow the case to be presented to either State, as discussed in paragraph 19 of the OECD Commentary quoted in paragraph 4 of the Commentary below. It was unable to reach agreement on whether or not that change should be made and invites the Committee to discuss the proposal*.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The 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.

4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, may develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this article. In addition, a competent authority may devise appropriate unilateral procedures, conditions, methods and techniques to facilitate the above-mentioned bilateral actions and the implementation of the mutual agreement procedure.

***Note from the Subcommittee**: An alternative would be to delete the last two sentences, which do not seem to be used in practice, The Subcommittee also notes that a requirement similar to the one included in the penultimate sentence is included in Articles 10, 11 and 12 and does not seem, in many cases, to be complied with in practice.*

COMMENTARY

Article 25

MUTUAL AGREEMENT PROCEDURE

***Note from the Subcommittee**: The revision of the Commentary would also need to take account of any additional changes that could be made to the Article.*

A. GENERAL CONSIDERATIONS

1. Article 25 of the United Nations Model Convention reproduces Article 25 of the OECD Model Convention with two substantive changes, namely, the addition of the second and third sentences in paragraph 4 and the omission of paragraph 5 of the OECD Model, which deals with the arbitration of issues that would otherwise prevent a mutual agreement.

2. The mutual agreement procedure is designed not only to furnish a means of settling questions relating to the interpretation and application of the Convention, but also to provide (*a*) a forum in which residents of the States involved can seek redress for actions not in accordance with the Convention and (*b*) a mechanism for eliminating double taxation in cases not provided for in the Convention. The mutual agreement procedure applies in connection with all articles of the Convention, and, in particular, to article 7 on business profits, article 9 on associated enterprises, article 11 on interest, article 12 on royalties and article 23 on methods for the elimination of double taxation.

3. In some countries, however, constitutional or legal impediments may restrict the ability of the competent authorities to provide relief, in certain cases, through the mutual agreement procedure. Treaty negotiators should discuss any such impediments that they are aware of. The presence of such impediments should not, however, lead to a modification of the Article that would restrict its scope (especially if, in the future, such impediments are removed): the requirement that competent authorities "shall endeavour" to resolve the case does not entail an obligation to reach as solution and acknowledges that certain factors may affect the ability of a competent authority to reach a mutual agreement or provide relief.

B. COMMENTARY ON THE PARAGRAPHS OF ARTICLE 25

Paragraphs 1 and 2

4. These paragraphs reproduce the full text of paragraphs 1 and 2 of Article 25 of the OECD Model Convention. As regards the last sentence of paragraph 1, however, the Committee noted that, in bilateral negotiations, States may wish to agree on a different time limit for the presentation of the case to the competent authority of a Contracting State.

5. The following part of the Commentary on Article 25, paragraphs 1 and 2, of the OECD Model Convention (as it read on 22 October 2010) is applicable to the interpretation of these paragraphs:

> [7.] The rules laid down in paragraphs 1 and 2 provide for the elimination in a particular case of taxation which does not accord with the Convention. As is known, in such cases it is normally open to taxpayers to

litigate in the tax court, either immediately or upon the dismissal of their objections by the taxation authorities. When taxation not in accordance with the Convention arises from an incorrect application of the Convention in both States, taxpayers are then obliged to litigate in each State, with all the disadvantages and uncertainties that such a situation entails. So paragraph 1 makes available to taxpayers affected, without depriving them of the ordinary legal remedies available, a procedure which is called the mutual agreement procedure because it is aimed, in its second stage, at resolving the dispute on an agreed basis, i.e. by agreement between competent authorities, the first stage being conducted exclusively in the State of residence (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national) from the presentation of the objection up to the decision taken regarding it by the competent authority on the matter.

[8.] In any case, the mutual agreement procedure is clearly a special procedure outside the domestic law. It follows that it can be set in motion solely in cases coming within paragraph 1, i.e. cases where tax has been charged, or is going to be charged, in disregard of the provisions of the Convention. So where a charge of tax has been made contrary both to the Convention and the domestic law, this case is amenable to the mutual agreement procedure to the extent only that the Convention is affected, unless a connecting link exists between the rules of the Convention and the rules of the domestic law which have been misapplied.

[9.] In practice, the procedure applies to cases by far the most numerous where the measure in question leads to double taxation which it is the specific purpose of the Convention to avoid. Among the most common cases, mention must be made of the following:

— the questions relating to attribution to a permanent establishment of a proportion of the executive and general administrative expenses incurred by the enterprise, under paragraph 3 of Article 7;

— the taxation in the State of the payer in case of a special relationship between the payer and the beneficial owner of the excess part of interest and royalties, under the provisions of Article 9, paragraph 6 of Article 11 or paragraph 4 of Article 12[18];

— cases of application of legislation to deal with thin capitalisation when the State of the debtor company has treated interest as dividends, insofar as such treatment is based on clauses of a convention corresponding for example to Article 9 or paragraph 6 of Article 11;

— cases where lack of information as to the taxpayer's actual situation has led to misapplication of the Convention, especially in regard to the determination of residence (paragraph 2 of Article 4), the existence of a permanent establishment (Article 5), or the temporary nature of the services performed by an employee (paragraph 2 of Article 15).

[10.] Article 25 also provides machinery to enable competent authorities to consult with each other with a view to resolving, in the context of transfer pricing problems, not only problems of juridical double taxation but also those of economic double taxation, and especially those resulting from the inclusion of profits of associated enterprises under paragraph 1 of Article 9; the corresponding adjustments to be made in pursuance of paragraph 2 of the same Article thus fall within the scope of the mutual agreement procedure, both as concerns assessing whether they are well-founded and for determining their amount.

[11.] 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

[18] [Corresponds to paragraph 6 of Article 12 in the UN Model.]

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.

[12.] Whilst 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. Whilst 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.

[13.] The mutual agreement procedure is also applicable in the absence of any double taxation contrary to the Convention, once the taxation in dispute is in direct contravention of a rule in the Convention. Such is the case when one State taxes a particular class of income in respect of which the Convention gives an exclusive right to tax to the other State even though the latter is unable to exercise it owing to a gap in its domestic laws. Another category of cases concerns persons who, being nationals of one Contracting State but residents of the other State, are subjected in that other State to taxation treatment which is discriminatory under the provisions of paragraph 1 of Article 24.

[14.] 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.

[*paragraph 15 is omitted as it is not relevant for Article 25 of the UN Model*]

[16.] To be admissible objections presented under paragraph 1 must first meet a twofold requirement expressly formulated in that paragraph: in principle, they must be presented to the competent authority of the taxpayer’s State of residence (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national), and they must be so presented within three years of the first notification of the action which gives rise to taxation which is not in accordance with the Convention. The Convention does not lay down any special rule as to the form of the objections. The competent authorities may prescribe special procedures which they feel to be appropriate. If no special procedure has been specified, the objections may be presented in the same way as objections regarding taxes are presented to the tax authorities of the State concerned.

[17.] The requirement laid on the taxpayer to present his case to the competent authority of the State of which he is a resident (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national) is of general application, regardless of whether the taxation objected to has been charged in that or the other State and regardless of whether it has given rise to double taxation or not. If the taxpayer should have transferred his residence to the other Contracting State subsequently to the measure or taxation objected to, he must nevertheless still present his objection to the competent authority of the State of which he was a resident during the year in respect of which such taxation has been or is going to be charged.

[18.] However, in the case already alluded to where a person who is a national of one State but a resident of the other complains of having been subjected in that other State to an action or taxation which is discriminatory under paragraph 1 of Article 24, it appears more appropriate for obvious reasons to allow him, by way of exception to the general rule set forth above, to present his objection to the competent authority of the Contracting State of which he is a national. Finally, it is to the same competent authority that an objection has to be presented by a person who, while not being a resident of a Contracting State, is a national of a Contracting State, and whose case comes under paragraph 1 of Article 24.

[19.] On the other hand, Contracting States may, if they consider it preferable, give taxpayers the option of presenting their cases to the competent authority of either State. In such a case, paragraph 1 would have to be modified as follows:

> “1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of either Contracting State. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.”

[20.] The time limit of three years set by the second sentence of paragraph 1 for presenting objections is intended to protect administrations against late objections. This time limit must be regarded as a minimum,

so that Contracting States are left free to agree in their bilateral conventions upon a longer period in the interests of taxpayers, e.g. on the analogy in particular of the time limits laid down by their respective domestic regulations in regard to tax conventions. Contracting States may omit the second sentence of paragraph 1 if they concur that their respective domestic regulations apply automatically to such objections and are more favourable in their effects to the taxpayers affected, either because they allow a longer time for presenting objections or because they do not set any time limits for such purpose.

[21.] 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. 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, whilst 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 examples of such a situation given in paragraph 14 above).

[22.] 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.

[23.] 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.

[24.] 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. Where it is the combination of decisions or actions taken in both Contracting States that results in taxation not in accordance with the Convention, 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.

[25.] 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 whilst 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 42 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.

[26.] 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 the following paragraphs 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 the mutual agreement procedure. The circumstances in which a State would deny access to the mutual agreement procedure should be made clear in the Convention.

[27.] 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.

[28.] 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 whilst 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.

[29.] 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.

[30.] As regards the procedure itself, it is necessary to consider briefly the two distinct stages into which it is divided (cf. paragraph 7 above).

[31.] In the first stage, which opens with the presentation of the taxpayer's objections, the procedure takes place exclusively at the level of dealings between him and the competent authorities of his State of residence (except where the procedure for the application of paragraph 1 of Article 24 is set in motion by the taxpayer in the State of which he is a national). The provisions of paragraph 1 give the taxpayer concerned the right to apply to the competent authority of the State of which he is a resident, whether or not he has exhausted all the remedies available to him under the domestic law of each of the two States. On the other hand, that competent authority is under an obligation to consider whether the objection is justified and, if it appears to be justified, take action on it in one of the two forms provided for in paragraph 2.

[32.] If the competent authority duly approached recognises that the complaint is justified and considers that the taxation complained of is due wholly or in part to a measure taken in the taxpayer's State of residence, it must give the complainant satisfaction as speedily as possible by making such adjustments or allowing such reliefs as appear to be justified. In this situation, the issue can be resolved without resort to the mutual agreement procedure. On the other hand, it may be found useful to exchange views and information with the competent authority of the other Contracting State, in order, for example, to confirm a given interpretation of the Convention.

[33.] If, however, it appears to that competent authority that the taxation complained of is due wholly or in part to a measure taken in the other State, it will be incumbent on it, indeed it will be its duty — as clearly appears by the terms of paragraph 2 — to set in motion the mutual agreement procedure proper. It is important that the authority in question carry out this duty as quickly as possible, especially in cases where the profits of associated enterprises have been adjusted as a result of transfer pricing adjustments.

[34.] A taxpayer is entitled to present his case under paragraph 1 to the competent authority of the State of which he is a resident whether or not he may also have made a claim or commenced litigation under the domestic law of that State. If litigation is pending, the competent authority of the State of residence should not wait for the final adjudication, but should say whether it considers the case to be eligible for the mutual agreement procedure. If it so decides, it has to determine whether it is itself able to arrive at a satisfactory solution or whether the case has to be submitted to the competent authority of the other Contracting State. An application by a taxpayer to set the mutual agreement procedure in motion should not be rejected without good reason.

[35.] If a claim has been finally adjudicated by a court in the State of residence, a taxpayer may wish even so to present or pursue a claim under the mutual agreement procedure. In some States, the competent authority may be able to arrive at a satisfactory solution which departs from the court decision. In other States, the competent authority is bound by the court decision. It may nevertheless present the case to the competent authority of the other Contracting State and ask the latter to take measures for avoiding double taxation.

[36.] In its second stage - which opens with the approach to the competent authority of the other State by the competent authority to which the taxpayer has applied the procedure is henceforward at the level of dealings between States, as if, so to speak, the State to which the complaint was presented had given it its backing. But whilst this procedure is indisputably a procedure between States, it may, on the other hand, be asked:

— whether, as the title of the Article and the terms employed in the first sentence of paragraph 2 suggest, it is no more than a simple procedure of mutual agreement, or constitutes the implementation of a *pactum de contrahendo* laying on the parties a mere duty to negotiate but in no way laying on them a duty to reach agreement;

— or whether on the contrary, it is to be regarded (based …[19] on the assumption that the procedure takes place within the framework of a joint commission) as a procedure of a jurisdictional nature laying on the parties a duty to resolve the dispute.

[37.] Paragraph 2 no doubt entails a duty to negotiate; but as far as reaching mutual agreement through the procedure is concerned, the competent authorities are under a duty merely to use their best endeavours and not to achieve a result[...][20].

[38.] In seeking a mutual agreement, the competent authorities must first, of course, determine their position in the light of the rules of their respective taxation laws and of the provisions of the Convention, which are as binding on them as much as they are on the taxpayer. Should the strict application of such rules or provisions preclude any agreement, it may reasonably be held that the competent authorities, as in the case of international arbitration, can, subsidiarily, have regard to considerations of equity in order to give the taxpayer satisfaction.

[39.] The purpose of the last sentence of paragraph 2 is to enable countries with time limits relating to adjustments of assessments and tax refunds in their domestic law to give effect to an agreement despite such time limits. This provision does not prevent, however, such States as are not, on constitutional or other legal grounds, able to overrule the time limits in the domestic law from inserting in the mutual agreement itself such time limits as are adapted to their internal statute of limitation. In certain extreme cases, a Contracting State may prefer not to enter into a mutual agreement, the implementation of which would require that the internal statute of limitation had to be disregarded. Apart from time limits there may exist other obstacles such as “final court decisions” to giving effect to an agreement. Contracting States are free to agree on firm provisions for the removal of such obstacles. As regards the practical implementation of the procedure, it is generally recommended that every effort should be made by tax administrations to ensure that as far as possible the mutual agreement procedure is not in any case frustrated by operational delays or, where time limits would be in point, by the combined effects of time limits and operational delays.

[40.] The Committee on Fiscal Affairs made a number of recommendations on the problems raised by corresponding adjustments of profits following transfer pricing adjustments (implementation of paragraphs 1 and 2 of Article 9) and of the difficulties of applying the mutual agreement procedure to such situations:

a) *Tax* authorities should notify taxpayers as soon as possible of their intention to make a transfer pricing adjustment (and, where the date of any such notification may be important, to ensure that a clear formal notification is given as soon as possible), since it is particularly useful to ensure as early and as full contacts as possible on all relevant matters between tax authorities and taxpayers within the same jurisdiction and, across national frontiers, between the associated enterprises and tax authorities concerned.

b) Competent authorities should communicate with each other in these matters in as flexible a manner as possible, whether in writing, by telephone, or by face-to-face or round-the-table discussion, whichever is most suitable, and should seek to develop the most effective ways of solving relevant problems. Use of the provisions of Article 26 on the exchange of information

[19] The words that have been omitted are not relevant for Article 25 of the UN Model.
[20] The sentence that has been omitted is not relevant for Article 25 of the UN Model.

should be encouraged in order to assist the competent authority in having well-developed factual information on which a decision can be made.

c) In the course of mutual agreement proceedings on transfer pricing matters, the taxpayers concerned should be given every reasonable opportunity to present the relevant facts and arguments to the competent authorities both in writing and orally.

[41.] As regards the mutual agreement procedure in general, the Committee recommended that:

a) The formalities involved in instituting and operating the mutual agreement procedure should be kept to a minimum and any unnecessary formalities eliminated.

b) Mutual agreement cases should each be settled on their individual merits and not by reference to any balance of the results in other cases.

c) Competent authorities should, where appropriate, formulate and publicise domestic rules, guidelines and procedures concerning use of the mutual agreement procedure.

[42.] 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 that suit. 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. [...][21] 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.

[43.] 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.

[44.] 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.

[21] The sentence that has been omitted is not relevant for Article 25 of the UN Model.

[45.] 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, necessary to take into account the concern of a particular competent authority to avoid any divergences or contradictions between the decision of the court and the mutual agreement that is being sought, with the difficulties or risks of abuse that these could entail. In short, therefore, 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 the suit at law concerning those points settled in the mutual agreement.

[46]. 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 14 above) and in the acceptance that there is clearly no such requirement for a procedure initiated by a competent authority under paragraph 3.

[47.] 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 the 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.

[48.] 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.

[49.] 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.

Paragraph 3

6. This paragraph reproduces Article 25, paragraph 3, of the OECD Model Convention. The following part of the OECD Commentary (as it read on 22 October 2010) is therefore applicable to the interpretation of the paragraph:

[50.] The first sentence of this paragraph invites and authorises the competent authorities to resolve, if possible, difficulties of interpretation or application by means of mutual agreement. These are essentially difficulties of a general nature which concern, or which may concern, a category of taxpayers, even if they have arisen in connection with an individual case normally coming under the procedure defined in paragraphs 1 and 2.

[51.] This provision makes it possible to resolve difficulties arising from the application of the Convention. Such difficulties are not only those of a practical nature, which might arise in connection with the setting up and operation of procedures for the relief from tax deducted from dividends, interest and royalties in the Contracting State in which they arise, but also those which could impair or impede the normal operation of the clauses of the Convention as they were conceived by the negotiators, the solution of which does not depend on a prior agreement as to the interpretation of the Convention.

[52.] Under this provision the competent authorities can, in particular:

— where a term has been incompletely or ambiguously defined in the Convention, complete or clarify its definition in order to obviate any difficulty;

— where the laws of a State have been changed without impairing the balance or affecting the substance of the Convention, settle any difficulties that may emerge from the new system of taxation arising out of such changes;

— determine whether, and if so under what conditions, interest may be treated as dividends under thin capitalisation rules in the country of the borrower and give rise to relief for double taxation in the country of residence of the lender in the same way as for dividends (for example relief under a parent/subsidiary regime when provision for such relief is made in the relevant bilateral convention).

[53.] Paragraph 3 confers on the “competent authorities of the Contracting States”, i.e. generally the Ministers of Finance or their authorised representatives normally responsible for the administration of the Convention, authority to resolve by mutual agreement any difficulties arising as to the interpretation of the Convention. However, it is important not to lose sight of the fact that, depending on the domestic law of Contracting States, other authorities (Ministry of Foreign Affairs, courts) have the right to interpret international treaties and agreements as well as the “competent authority” designated in the Convention, and that this is sometimes the exclusive right of such other authorities..

[54.] Mutual agreements resolving general difficulties of interpretation or application are binding on administrations as long as the competent authorities do not agree to modify or rescind the mutual agreement..

[55.] 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 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 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 these situations the Convention could be complemented by a protocol 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.

Paragraph 4

7. This paragraph consists of three sentences, the first of which reproduces the first sentence of Article 25, paragraph 4, of the OECD Model Convention, while the second and third sentences are not contained in that Model. In the first sentence, the words "including through a joint commission consisting of themselves or their representatives" have been inserted in 1999 between the words "with each other directly" and ". . . for the purpose of reaching", so as to bring the provision on a par with that of the corresponding provision in the OECD Model Convention. The following part of the OECD Commentary (as it read on 22 October 2010) is applicable to the interpretation of the paragraph:

> [56.] This paragraph determines how the competent authorities may consult together for the resolution by mutual agreement, either of an individual case coming under the procedure defined in paragraphs 1 and 2 or of general problems relating in particular to the interpretation or application of the Convention, and which are referred to in paragraph 3.
>
> [57.] It provides first that the competent authorities may communicate with each other directly. It would therefore not be necessary to go through diplomatic channels.
>
> [58.] The competent authorities may communicate with each other by letter, facsimile transmission, telephone, direct meetings, or any other convenient means. They may, if they wish, formally establish a joint commission for this purpose.
>
> [59.] As to this joint commission, paragraph 4 leaves it to the competent authorities of the Contracting States to determine the number of members and the rules of procedure of this body.
>
> [60.] However, whilst the Contracting States may avoid any formalism in this field, it is nevertheless their duty to give taxpayers whose cases are brought before the joint commission under paragraph 2 certain essential guarantees, namely:
>
> — the right to make representations in writing or orally, either in person or through a representative;
>
> — the right to be assisted by counsel.
>
> [61.] However, disclosure to the taxpayer or his representatives of the papers in the case does not seem to be warranted, in view of the special nature of the procedure.
>
> [62.] Without infringing upon the freedom of choice enjoyed in principle by the competent authorities in designating their representatives on the joint commission, it would be desirable for them to agree to entrust the chairmanship of each Delegation — which might include one or more representatives of the service responsible for the procedure — to a high official or judge chosen primarily on account of his special experience; it is reasonable to believe, in fact, that the participation of such persons would be likely to facilitate reaching an agreement.

Note from the Subcommittee: The preceding paragraph 6 has been deleted because:

1) It did not relate to paragraph 4 of the Article.

2) The contents of the second and third subparagraphs (starting with "First" and "Secondly") were

similar to what is already included in paragraph 18 [renumbered 16 below].

3) The last subparagraph was potentially misleading as it is not correct to say that the implementation of the MAP is "delegated to the competent authorities": the MAP applies regardless of whether or not the competent authorities do anything for its implementation. Also, the meaning of the last sentence, according to which the last sentence of paragraph 1 of Article 25 is made "unnecessary …, except for those countries whose domestic law requires the insertion of the sentence", was unclear.

C. ADDITIONAL PROCEDURAL ISSUES RELATED TO THE MUTUAL AGREEMENT PROCEDURE

8. The last two sentences of paragraph 4 of Article 25 allow the competent authorities to develop procedures, bilaterally and unilaterally, for the implementation of the mutual agreement procedure. The following discuss various procedural aspects of the mutual agreement procedure and include suggestions concerning procedures that could be adopted by the competent authorities. These suggestions are not exhaustive and should be adapted or supplemented based on the experience and circumstances of each country.

Note from the Subcommittee: The first sentence of this paragraph should be deleted if the last two sentences of paragraph 4 are deleted.

Note from the Subcommittee: Previous paragraph 8 has been deleted as it dealt with the issue of arbitration .

Note from the Subcommittee: This previous paragraph 9, which dealt with the interaction between MAP and the GATS has been moved to the end of the Commentary.

(a) Aspects of the mutual agreement procedure that should be dealt with

9. The procedural arrangements for mutual agreements in general should be suitable to the number and types of issues expected to be dealt with by the competent authorities and to the administrative capability and resources of those authorities. The arrangements should not be rigidly structured but instead should embody the degree of flexibility required to facilitate consultation and agreement rather than hinder them by elaborate procedural requirements and mechanisms. But even relatively simple procedural arrangements must incorporate certain minimum rules that inform taxpayers of their essential rights and obligations under the mutual agreement procedure. Such minimum rules would appear to involve such questions as:

- At what stage in his tax matter a taxpayer can invoke action by the competent authority under the mutual agreement procedure;
- Whether any particular form must be followed by a taxpayer in invoking action by the competent authority;
- Whether any time limits are applicable to a taxpayer's invocation of action by the competent authority;
- If a taxpayer invokes action by the competent authority, whether he is bound by the decision of the competent authorities and whether he must waive recourse to other administrative or judicial processes as a condition for the implementation of a proposed mutual agreement reached by the competent authorities;
- In what manner, if at all, a taxpayer can participate in the competent authority proceedings and what requirements regarding the furnishing of information by a taxpayer are involved.

(b) Necessary cooperation of the person who makes the request.

10. The successful outcome of the mutual agreement procedure depends to a large extent on the full cooperation of the person who made the request. That person must, in particular, help the competent authorities to establish the facts on which the case is based. That requires the person to make a full and accurate disclosure of all relevant facts and supporting evidence known to that person. Where, in particular, transactions have been carried on in the other Contracting State, the person who made the request must provide the relevant documents establishing the conditions of these transactions and supply complete information on the circumstances of these transactions.

11 The competent authority may require that the person making the request provide the following as early as possible:

— a description of the general background for the case, which would include a description of the business activities of the relevant persons as well as a description of the contracts and arrangements that provide that general background, such as a shareholders' agreement, a partnership agreement, a licence agreement or a project agreement;

— the details of the situation that allegedly resulted or will result in taxation that is not in accordance with the provisions of the Convention, which could include, for example, the details of transactions or events (e.g. a payment or the delivery of a good or service) that were characterized in a certain way by the tax administration of the other Contracting State, supported by all the relevant documentation and, especially, the documents that have been presented to the tax administration of the other Contracting State;

— the amounts of income and tax involved (or an estimate thereof), the relevant financial statements;

— a description of the relevant taxation years or periods affected by the case (in each State, where these are different);

— a description of the status of the procedure in the other Contracting State, e.g. whether a tax audit report has been produced, a tax assessment received, an appeal filed or litigation undertaken, and

— a reference to the relevant provisions of the applicable tax treaty and the analysis supporting the claim that there is or will be taxation not in accordance with these provisions (when available, the legal analysis of the tax authorities of the other Contracting State should also be provided).

12. It may be more difficult to obtain some of the above information when the relevant transactions involve third parties which are not associated to the person making the request. Also, all that information might not be available at the time the request is made. The information provided at the initial stage should, however, be sufficient to allow the competent authority to which the case is presented to determine whether the objection is justified. A competent authority would not be able to initiate a mutual agreement procedure where the person making the request provides insufficient or inadequate information.

13. The mutual agreement procedure is only available in cases where a person considers that the actions of one or both States result or will result in taxation that is not in accordance with the provisions of the Convention. There may be cases where double taxation will arise because a taxpayer has failed to observe procedural rules (e.g. the expiry of time limits) without there being any taxation contrary to the provision of the Convention; in those cases, the mutual agreement procedure will not be available.

(c) Information on adjustments

14. The competent authorities should decide on the extent of the information to be provided on adjustments involving income allocation and the time when it is to be given by one competent authority to the other. Thus, the information could cover adjustments proposed or finalized by the tax administration of one country, the related entities involved and the general nature of the adjustments.

15. Generally speaking, most competent authorities are likely to conclude that the automatic transmittal of such information is not needed or desirable. The competent authority of the country making an adjustment may find it difficult or time-consuming to gather the information and prepare it in a suitable form for transmission. In addition, the other competent authority may find it burdensome merely to process a volume of data routinely transmitted by the first competent authority. Moreover, a taxpaying corporation can usually be counted upon to inform its related entity in the other country of the proceedings and the latter is thus in a position to inform, in turn, its competent authority. For this reason, the functioning of a consultation system would be aided if a tax administration considering an adjustment possibly involving an international aspect were to give the taxpayer as much warning as possible.

16. Some competent authorities, while not wishing to be informed routinely of all adjustments in the other country, may desire to receive, either from their own taxpayers or from the other competent authority, "early warning" of serious cases or of the existence of a significant degree or pattern of activity respecting particular types of cases; similarly, they may want to transmit such information. In this event, a process should be worked out for obtaining the information. Some competent authorities may want to extend this early warning system to less serious cases, thus covering a larger number of cases.

(d) Initiation of competent authority consultation at the point of proposed or finalized adjustments

17. Paragraph 1 of the Article includes general rules concerning the presentation of a case by the taxpayer. The competent authority to which a case is validly presented must first examine whether it is itself able to arrive at a satisfactory solution. If it is unable to do so, it must determine at what stage it will consult the competent authority of the other State.

18. Many competent authorities, at least in the early stages of their experience, would prefer that the consultation process with the other State not be initiated at the point of a proposed adjustment and probably not even at the point of a finalized adjustment. A proposed adjustment may never result in final action and even a finalized adjustment may or may not trigger a claim for a correlative adjustment; even if it does, the latter adjustment may occur without problems. As a consequence, many competent authorities may decide that the consultation process should not be initiated until the correlative adjustment (or other tax consequence in the second country) is involved at some point.

19. However, some competent authorities prefer that the bilateral process be initiated earlier, perhaps at the proposed adjustment stage. Such involvement may make the process of consultation easier, in that the first country will not have an initial fixed position. In such a case, the other competent authority should be prepared to discuss the case at this early stage with the first competent authority. Other competent authorities may be willing to let the taxpayer decide, and thus stand ready to have the process invoked at any point starting with the proposed adjustment.

20. At a minimum, taxpayers must be informed when they can invoke the mutual agreement procedure and which competent authority is to be addressed. Taxpayers should also be informed in what form the request should be submitted, although it is likely that a simple form would normally be suitable.

(e) Correlative adjustments

(i) *Governing rule*

Note from the Subcommittee: The preceding three paragraphs have been deleted because they deal with paragraph 2 of Article 9 rather than with the mutual agreement procedure itself. They may, however, be moved to the Commentary on Article 9 if the Committee wants to keep them.

21. It is recognized that, to be effective, a treaty with a correlative adjustment provision based on paragraph 2 of Article 9 must also provide that any domestic law procedural or other barriers to the making of the correlative adjustment are to be

disregarded. Thus, such provisions as statutes of limitations and finality of assessments would have to be overridden to permit the correlative adjustment to be made, as required by the last sentence of paragraph 2 of Article 25. If a particular country cannot, through a treaty, override such aspects of its domestic law, this would have to be provided for in the treaty, although it would be hoped that domestic law could be amended to permit the treaty to operate so as to avoid the need for such exceptional provision.

Note from the Subcommittee: The preceding paragraph is really an introduction to the following paragraph and has therefore been merged with it.

(ii) *Competent authority procedure*

22. Paragraph 2 of Article 9 does not prescribe the method of the correlative adjustment since this depends on the nature of the initial adjustment and its effect on the tax payable on the profits of the associated enterprise. The method of the correlative adjustment is thus an aspect of the substantive issue underlying the initial adjustment. Given the correlative adjustment requirement imposed by Article 9, it is clear that the mutual agreement procedure must be available at this point. Thus, if the tax authorities of the Contracting State that is required to make such an adjustment do not themselves work out the correlative adjustment, the taxpayers should be entitled to invoke the mutual agreement procedure. When a taxpayer invokes the competent authority of a Contracting State, that competent authority may be in a position to dispose of the matter without having to consult the competent authority of the other country, as provided in the first part of paragraph 2 of Article 25. For example, that competent authority may be in a position to handle a matter having potential international consequences that arises from an adjustment proposed by a political subdivision of a State even if the competent authority represents the government of the central government of that State. This is, of course, an aspect of domestic law as affected by the treaty.

23. As a minimum procedural aspect, the competent authorities should indicate the extent to which a taxpayer may be allowed to participate in the competent authority procedure and the manner of his participation. Some countries may wish to favour a reasonable degree of taxpayer participation. Some countries may wish to allow a taxpayer to present information and even to appear before them; others may restrict the taxpayer to the presentation of data. Presumably, the competent authorities would make it a condition that a taxpayer invoking the procedure be required to submit to them relevant information needed to decide the matter. In addition, some competent authorities may, where appropriate, require that data furnished by a taxpayer be prepared as far as possible in accordance with internationally accepted accounting standards so the data provided will have some uniformity and objectivity. It is to be noted that rapid progress is being made in developing international accounting standards and the work of competent authorities should be aided by this development. As a further aspect concerning the taxpayer's participation, there should be a requirement that the taxpayer who invokes the mutual agreement procedure should be informed of the response of the competent authority.

24. The competent authorities will have to decide how their consultation should proceed once that part of the procedure comes into operation. Presumably, the nature of the consultation will depend on the number and character of the cases involved. The competent authorities should keep the consultation procedure flexible and leave every method of communication open, so that the method appropriate to the matter at hand can be used.

25. Various alternatives are available, such as informal consultation by telecommunication or in person; meetings between technical personnel or auditors of each country, whose conclusions are to be accepted or ratified by the competent authorities; appointment of a joint commission for a complicated case or a series of cases; formal meetings of the competent authorities in person etc. It does not seem desirable to place a time limit on when the competent authorities must conclude a matter, since the complexities of particular cases may differ. Nevertheless, competent authorities should develop working habits that are conducive to prompt disposition of cases and should endeavour not to

allow undue delay.

26. As discussed in paragraphs 25 and 42 of the OECD Commentary quoted in paragraph 4 above an important minimum procedural aspect of the competent authority procedure is the effect of a taxpayer's invocation of that procedure. Must a taxpayer who invokes that process be bound by the decision of the competent authorities in the sense that he gives up rights to alternative procedures, such as recourse to domestic administrative or judicial procedures? If the competent authorities want their procedure to be exclusive and binding, it would be necessary that the treaty provisions be so drawn as to permit this result. Presumably, this may be accomplished under the general delegation in article 25, paragraph 4, by requiring the taxpayer to waive recourse to those alternative procedures. (However, even with this guideline paragraph, some countries may consider that their domestic law requires a more explicit statement to permit the competent authority procedure to be binding, especially in view of paragraph 1 of guideline 25[20] referring to remedies under national laws and of the present practice under treaties not to make the procedure a binding one.) Some competent authorities may desire that their actions be binding, since they will not want to go through the effort of reaching agreements only to have the taxpayer reject the result if he feels he can do better in the courts or elsewhere. Other competent authorities may desire to follow the present practice and thus may not want to bind taxpayers or may not be in a position to do so under domestic law. This would appear to be a matter on which developing experience would be a useful guide.

27. A basic issue regarding the competent authority procedure is the extent to which the competent authorities should consider themselves under obligation to reach an agreement on a matter that comes before them. At a minimum, the treaty requires consultation and the obligation to endeavour to find a solution to economic double taxation. But must the consultation end in agreement? Presumably, disagreement would, in general, leave the related entities in a situation where double taxation may result contrary to the treaty, for example, when a country has opposed a correlative adjustment on the grounds that the initial adjustment was not in conformity with the arm's length standard. On the other hand, an agreement would mean a correlative adjustment made, or a change in the initial adjustment followed then by a correlative adjustment, or perhaps the withdrawal of the initial adjustment. In essence, the general question is whether the competent authority consultation is to be governed by the requirement that there be an "agreement to agree".

28. In practice, this question is not as serious as it may seem. The experience of most competent authorities is that in the end an agreement or solution is almost always reached. Of course, the solution may often be a compromise, but compromise is an essential aspect of the process of consultation and negotiation. Hence, in reality, it would not be much of a further step for competent authorities to decide that their procedure should be governed by the standard of "agreement to agree". However, some countries would consider the formal adoption of such standard as a step possessing significant juridical consequences and hence would not be disposed to adopt such a requirement.

29. It is recognized that, for some countries, the process of agreement might well be facilitated if competent authorities, when faced with an extremely difficult case or an impasse, could call, either informally or formally, upon outside experts to give an advisory opinion or otherwise assist in the resolution of the matter. Such experts could be persons currently or previously associated with other tax administrations and possessing the requisite experience in this field. In essence, it would largely be the personal operation of these experts that would be significant. This resort to outside assistance could be useful even where the competent authorities are not operating under the standard of an "agreement to agree", since the outside assistance, by providing a fresh point of view, may help to resolve an impasse.

(f) Publication of competent authority procedures and determinations

[20] For any reference to "guideline", please refer to the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* (United Nations publication, Sales No. E.79.XVI.3).

30. The competent authorities should make public the procedures they have adopted with regard to their consultation procedure. The description of the procedures should be as complete as is feasible and at the least should contain the minimum procedural aspects discussed above.

31. Where the consultation procedure has produced a substantive determination in an important area that can reasonably be viewed as providing a guide to the viewpoints of the competent authorities, the competent authorities should develop a procedure for publication in their countries of that determination or decision.

(g) Procedures to implement adjustments

32. The competent authorities should consider what procedures may be required to implement the various adjustments involved. For example:

(i) The first country may consider deferring a tax payment under the adjustment or even waiving the payment if, for example, payment or reimbursement of an expense charge by the associated enterprise is prohibited at the time because of currency or other restrictions imposed by the second country.

(ii) The first country may consider steps to facilitate carrying out the adjustment and payment of a reallocated amount. Thus, if income is imputed and taxed to a parent corporation because of service to a related foreign subsidiary, the related subsidiary may be allowed, as far as the parent country is concerned, to establish on its book an account payable in favour of the parent, and the parent will not be subject to a second tax in its country on the establishment or payment of the amount receivable. Such payment should not be considered a dividend by the country of the subsidiary.

(iii) The second country may consider steps to facilitate carrying out the adjustment and payment of a reallocated amount. This may, for example, involve recognition of the payment made as a deductible item, even though prior to the adjustment there was no legal obligation to pay such amount. This is really an aspect of the correlative adjustment.

(h) Unilateral procedures

33. The above discussion has related almost entirely to bilateral procedures to be agreed upon by the competent authorities to implement the mutual agreement procedure. In addition, a competent authority may consider it useful to develop certain unilateral rules or procedures involving its relationship to its own taxpayers, so that these relationships may be better understood. These unilateral rules can cover such matters as the form to be followed in bringing matters to the attention of the competent authority; the permission to taxpayers to bring matters to the competent authority at an early stage even where the bilateral procedure does not require consultation at that stage; the question whether the competent authority will raise new domestic issues (so-called affirmative issues) between the tax authorities and the taxpayer if he goes to the competent authority; and requests for information that will assist the competent authority in handling cases.

34. Unilateral rules regarding the operation of a competent authority would not require agreement to them by the other competent authority, since the rules are limited to the domestic relationship with its own taxpayers. However, it would seem appropriate to communicate such unilateral rules to the other treaty competent authorities, and to avoid wherever possible material differences, if any, in such rules in relation to the various treaties.

Note from the Subcommittee: This previous paragraph 9, which dealt with the interaction between

MAP and the GATS, has been moved to the end of the Commentary.

D. ARBITRATION OF UNRESOLVED ISSUES

35. 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. The following is an example of the provision that could be used for that purpose:

> 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 three 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 either competent authority so requests and the person who has presented the case is notified of the request. 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. The arbitration decision shall be binding on both States and shall be implemented notwithstanding any time limits in the domestic laws of these States unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.

36. This provision reproduces paragraph 5 of Article 25 of the OECD Model Convention with four differences. First, it provides that arbitration may be initiated if the competent authorities are unable to reach an agreement on a case within three years from the presentation of that case rather than within two years as provided in the OECD Model. Second, while the OECD Model provides that arbitration must be requested by the person who initiated the case, this provision provides that this must be done by the competent authority of one of the Contracting States. Third, this provision, unlike the corresponding provision of the OECD Model, allows the competent authorities to depart from the arbitration decision if they agree to do so within six months after the decision has been communicated to them. Finally, the footnote that is found in the OECD Model, according to which the inclusion of the provision may not be appropriate in certain circumstances, has been omitted as the provision is merely included here as an example to be used by States that have concluded that an arbitration provision should be included in their convention. Paragraphs 63 to 85 of the Commentary on paragraph 5 of Article 25 of the OECD Model Convention, together with its Annex, (as they read on 22 October 2010) would be applicable to the interpretation and the application of this provision subject to the differences described above.

37. The above provision provides for mandatory arbitration under which the competent authorities are obliged to submit a case to arbitration if one of them so requests after they were unable to resolve that case within a given period of time. For different reasons, some States consider that it is not appropriate to commit themselves to go for arbitration whenever the competent authority of the other Contracting State so requests. Those States may, however, wish to include in their treaties a voluntary arbitration provision under which both competent authorities must agree, on a case by case basis, to submit a case to arbitration before it can proceed to arbitration. An example of such an additional paragraph could read:

> If any difficulty or doubt arising as to the interpretation or application of the Convention cannot be resolved by the competent authorities pursuant to the preceding paragraphs of this article, the case may be submitted to arbitration if both competent authorities so agree and, in a specific case, if the person who has presented the case is notified of the request for arbitration. The arbitration decision in a specific case shall be binding on both States with respect to that case and shall be implemented notwithstanding any time limits in the domestic law of those States, unless both competent authorities agree on a different solution within six months after the decision has been communicated to them or unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.

Where two Contracting States that have not included such paragraph in their Convention wish to implement an arbitration process for general application or to deal with a specific case, it is always possible for them to do so by mutual agreement.

38. Voluntary arbitration allows greater control over the types of cases that will 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 inappropriate for that issue to be submitted to arbitration. Under voluntary arbitration countries preserve great flexibility as to the issues that will be subjected to arbitration and may restrict the potential number of cases that could proceed to arbitration and reduce the potential costs of arbitration.

39. Under voluntary arbitration, however, the competent authority of one State systematically refusing to depart from its own interpretations of the treaty with respect to specific issues may systematically refuse to submit those issues to arbitration. The arbitration of issues on which the competent authorities disagree is essential to ensure that treaty disputes are effectively solved in a consistent manner in both States. Mandatory arbitration ensures the final resolution of such cases while voluntary arbitration fails to do so.

E. INTERACTION BETWEEN THE MUTUAL AGREMENT PROCEDURE AND THE DISPUTE RESOLUTION MECHANISM OF THE GATS

40. In some rare cases, a dispute between countries concerning the application of the national treatment rule of Article XVII of the General Agreement on Trade in Services (GATS) to taxes covered by a tax treaty could lead to both the MAP and the dispute resolution mechanism of the GATS being applicable to address the issue. This problem, the solution adopted in the GATS with respect to tax treaties that existed at the time that it entered in force and a possible solution with respect to subsequent tax treaties are discussed in the following parts of the OECD Commentary (as it read on 22 October 2010), which countries may want to take into account when negotiating a tax treaty:

> [88.] The application of the General Agreement on Trade in Services (GATS), which entered into force on 1 January 1995 and which all member countries have signed, raises particular concerns in relation to the mutual agreement procedure.
>
> [89.] Paragraph 3 of Article XXII of the GATS provides that a dispute as to the application of Article XVII of the Agreement, a national treatment rule, may not be dealt with under the dispute resolution mechanisms provided by Articles XXII and XXIII of the Agreement if the disputed measure "falls within the scope of an international agreement between them relating to the avoidance of double taxation" (e.g. a tax convention). If there is disagreement over whether a measure "falls within the scope" of such an

international agreement, paragraph 3 goes on to provide that either State involved in the dispute may bring the matter to the Council on Trade in Services, which shall refer the dispute for binding arbitration. A footnote to paragraph 3, however, contains the important exception that if the dispute relates to an international agreement "which exist[s] at the time of the entry into force" of the Agreement, the matter may not be brought to the Council on Trade in Services unless both States agree.

[90.] That paragraph raises two particular problems with respect to tax treaties.

[91.] First, the footnote thereto provides for the different treatment of tax conventions concluded before and after the entry into force of the GATS, something that may be considered inappropriate, in particular where a convention in existence at the time of the entry into force of the GATS is subsequently renegotiated or where a protocol is concluded after that time in relation to a convention existing at that time.

[92.] Second, the phrase "falls within the scope" is inherently ambiguous, as indicated by the inclusion in paragraph 3 of Article XXII of the GATS of both an arbitration procedure and a clause exempting pre-existing conventions from its application in order to deal with disagreements related to its meaning. Whilst it seems clear that a country could not argue in good faith[22] that a measure relating to a tax to which no provision of a tax convention applied fell within the scope of that convention, it is unclear whether the phrase covers all measures that relate to taxes that are covered by all or only some provisions of the tax convention.

[93.] Contracting States may wish to avoid these difficulties by extending bilaterally the application of the footnote to paragraph 3 of Article XXII of the GATS to conventions concluded after the entry into force of the GATS. Such a bilateral extension, which would supplement but not violate in any way the Contracting States' obligations under the GATS, could be incorporated in the convention by the addition of the following provision:

> "For purposes of paragraph 3 of Article XXII (Consultation) of the General Agreement on Trade in Services, the Contracting States agree that, notwithstanding that paragraph, any dispute between them as to whether a measure falls within the scope of this Convention may be brought before the Council for Trade in Services, as provided by that paragraph, only with the consent of both Contracting States. Any doubt as to the interpretation of this paragraph shall be resolved under paragraph 3 of Article 25 or, failing agreement under that procedure, pursuant to any other procedure agreed to by both Contracting States."

[94.] Problems similar to those discussed above may arise in relation with other bilateral or multilateral agreements related to trade or investment. Contracting States are free, in the course of their bilateral negotiations, to amend the provision suggested above so as to ensure that issues relating to the taxes covered by their tax convention are dealt with through the mutual agreement procedure rather than through the dispute settlement mechanism of such agreements.

[22] The obligation of applying and interpreting treaties in good faith is expressly recognized in Articles 26 and 31 of the *Vienna Convention on the Law of Treaties*; thus, the exception in paragraph 3 of Article XXII of the GATS applies only to good faith disputes.

ANNEX 4

ARBITRATION PROVISIONS IN CURRENT TAX TREATIES

Treaties allow the submission of a case to arbitration on all issues related to the interpretation or application of the treaty, but only if both competent authorities and the taxpayer agree to do so, so that the procedure is not mandatory for the competent authorities. A condition is also that the taxpayer agrees to be bound by the arbitration decision.

Some examples follow:

Canada - Mexico Income Tax Treaty (12/09/2006)
Canada - Ecuador Income Tax Treaty (28/06/2001)
Israel - Mexico Income and Capital Tax Treaty (20/07/1999)
Indonesia - Mexico Income Tax Treaty (06/09/2002)
Canada - Namibia Income and Capital Tax Treaty (25/03/2010)

> *"If any difficulty or doubt arising as to the interpretation or application of the Convention cannot be resolved by the competent authorities pursuant to the preceding paragraphs of this Article, the case may be submitted for arbitration if both competent authorities and the taxpayer agree and 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 procedure shall be established in an exchange of notes between the Contracting States."*

Italy - Jordan Income Tax Treaty (16/03/2004)

> *"5. In the cases provided for in the preceding paragraphs, if the competent authorities of the Contracting States do not reach an agreement for the avoidance of double taxation within two years from the date on which the case has been first presented to one of them, and the taxpayer(s) agree(s) to be bound by the decision of an arbitration board, the competent authorities may establish such an arbitration board for each specific case, which is entrusted with giving an expert opinion on the method for the elimination of double taxation. The board can only be established if the parties concerned previously waive-without any reservations or conditions-the pending legal proceedings at the domestic court.*
> *The arbitration board shall consist of three members appointed in the following manner: each competent authority shall appoint a member and the two members shall appoint by mutual agreement the chairman who shall be chosen among independent experts from either Contracting State or from another country*
> *When giving its opinion, the arbitration board shall apply the provisions of this Convention and principles of international law, taking into account the domestic laws of the Contracting States. The arbitration board shall establish its own rules of procedure.*
> *The person concerned may upon request be heard or be represented before the arbitration board and, when requested by the board, such person shall appear before it or appoint a representative for such purpose.*
>
> *6. The opinion of the arbitration board shall be given within six months from the date on which the case has been presented. The board shall rule with a majority vote of its members. In case of divergence of the voting of the members appointed by each competent authority, the chairman's vote shall prevail.*
>
> *7. Each Contracting State shall bear the cost of the arbitrator it has appointed and of its representation in the arbitral proceedings. The cost of the chairman and the remaining costs shall be borne*

in equal parts by the Contracting States. The arbitration board may make a different regulation concerning costs.

8. The decisions of the board are final and binding for each Contracting State."

Other treaties allow the submission of the case to arbitration on all issues related to the interpretation or application of the treaty if one of the competent authorities so request. Examples:

Netherlands - South Africa Income and Capital Tax Treaty (10/10/2005)
Barbados - Netherlands Income Tax Treaty (28/11/2006)
Bahrain - Netherlands Income Tax Treaty (16/04/2008)
Netherlands - Uganda Income Tax Treaty (31/08/2004)
Ghana - Netherlands Income Tax Treaty (10/03/2008)
Bermuda - Netherlands Income Tax Treaty (8/06/2009)

"If any difficulty or doubt arising as to the interpretation or application of the Convention cannot be resolved by the competent authorities of the Contracting States in a mutual agreement procedure pursuant to the previous paragraphs of this Article within a period of two years after the question was raised, the case may, at the request of either Contracting State, be submitted for arbitration, but only after fully exhausting the procedures available under paragraphs 1 to 4 of this Article and provided the taxpayer or taxpayers involved agree 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 Contracting States and the taxpayer or taxpayers involved with respect to that case. [The composition of the arbitration board and the arbitration procedures shall be determined by the competent authorities of the Contracting States.]"

South Africa - Switzerland Income Tax Treaty (08/05/2007)

"If any difficulty or doubt as to the interpretation or application of the Convention cannot be resolved by the competent authorities of the Contracting States in a mutual agreement procedure pursuant to the previous paragraphs of this Article within a period of three years after the question was raised, the case may, at the request of either Contracting State, be submitted for arbitration, but only after fully exhausting the procedures available under paragraphs 1 to 4 of this Article and provided the taxpayer or taxpayers involved agree in writing to be bound by the decision of the arbitration board. The arbitration board shall make a decision within one year after the case was submitted for arbitration. The decision of the arbitration board in a particular case shall be binding on both Contracting States and the taxpayer or taxpayers involved with respect to that case. The composition of the arbitration board and the arbitration procedures shall be determined by the competent authorities of the Contracting States."

Under other treaties the submission of the case to arbitration on all issues related to the interpretation or application of the treaty is mandatory, unless both competent authorities agree, before the date on which arbitration proceedings would otherwise have begun, that the case is not suitable for determination by arbitration . Example:

Belgium – United States Income Tax Treaty (26/11/2006)

"7. Where, pursuant to a mutual agreement procedure under this Article, the competent authorities have endeavored but are unable to reach a complete agreement in a case, the case shall be resolved through

arbitration conducted in the manner prescribed by, and subject to, the requirements of paragraph 8 and any rules or procedures agreed upon by the Contracting States, if:

a) tax returns have been filed with at least one of the Contracting States with respect to the taxable years at issue in the case;

b) 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; and

c) all concerned persons agree according to the provisions of subparagraph d) of paragraph 8.

8. For the purposes of paragraph 7 and this paragraph, the following rules and definitions shall apply:

a) the term "concerned person" means the presenter of a case to a competent authority for consideration under this Article and all other persons, if any, whose tax liability to either Contracting State may be directly affected by a mutual agreement arising from that consideration;

b) the "commencement date" for a case is the earliest date on which the information necessary to undertake substantive consideration for a mutual agreement has been received by both competent authorities;

c) arbitration proceedings in a case shall begin on the later of:

i) two years after the commencement date of that case, unless both competent authorities have previously agreed to a different date, and

ii) the earliest date upon which the agreement required by subparagraph d) has been received by both competent authorities;

d) the concerned person(s), and their authorized representatives or agents, must agree prior to the beginning of arbitration proceedings not to disclose to any other person any information received during the course of the arbitration proceeding from either Contracting State or the arbitration board, other than the determination of such board;

e) unless any concerned person does not accept the determination of an arbitration board, the determination shall constitute a resolution by mutual agreement under this Article and shall be binding on both Contracting States with respect to that case; and

f) for purposes of an arbitration proceeding under paragraph 7 and this paragraph, the members of the arbitration board and their staffs shall be considered "persons or authorities" to whom information may be disclosed under Article 25 (Exchange of Information and Administrative Assistance) of the Convention."

Under some treaties the submission of the case to arbitration on some issues related to the application of the treaty is mandatory. Example:

Australia - New Zealand Income Tax Treaty (26/06/2009)

"6. 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 reserved or 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.

7. The issues to which the provisions of paragraph 6 apply are:

a) issues of fact; and
b) issues which the Government of Australia and the Government of New Zealand agree, in an Exchange of Notes, shall be covered by the provisions of paragraph 6."

Under other treaties the submission of the case to arbitration on all issues related to the interpretation or application of the treaty is mandatory. Examples:

Austria - San Marino Income and Capital Tax Treaty (24/11/2004)

"5. In the cases provided for in the preceding paragraphs, if the competent authorities of the Contracting States fail to reach an agreement to avoid double taxation within two years from the first presentation of the case to any of them, the competent authorities shall set up, for each specific case, an Arbitration Court that shall be called upon to give its opinion on the mode of elimination of double taxation, provided that the taxpayer(s) undertake(s) to be bound by the relative decisions. The setting up of the Arbitration Court shall be conditional on the prior discontinuance - without reservations or conditions - of any actions pending in national courts.
The Arbitration Court shall consist of three members. Each competent authority shall designate, within 3 months from the end of the above-mentioned period, one member. The two members so designated shall designate jointly, within the same period, the President from among independent personalities belonging to the Contracting States or to a third OECD member State. In giving its opinion, the Court shall apply the provisions of this Convention and the general principles of international law, having regard to the domestic laws of the Contracting States. The Court itself shall determine the rules of the arbitration procedure.

Upon request, the taxpayer(s) has(have) the right to be heard by the Arbitration Court or to be represented .
6. The Court shall hand down its decision within 6 months from the date of appointment of the President. The decision shall be made by a simple majority. Within 6 months from the decision of the Arbitration Court, the competent authorities of the Contracting States may adopt measures, by mutual agreement, to eliminate the source of the controversy. The arbitration court shall deliver its decision not more than six months from the date on which the matter was referred to it. The decision shall be binding with regard to the individual case on both Contracting States and all taxpayers concerned."

Netherlands - Switzerland Income Tax Treaty (26/02/2010)

"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 three 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.
The Contracting States may release to the arbitration board, established under the provisions of this paragraph, such information as is necessary for carrying out the arbitration procedure. The members of the arbitration board shall be subject to the limitations on disclosure described in paragraph 2 of Article 26 with respect to information so released."

Belgium-UK Protocol (24/06/2009)

"5. Where,

(a) under paragraph 1 of this Article, 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 the 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 within two years from the first day from which arbitration may be requested. 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 Contracting State. Unless a person directly affected by the case informs the competent authority of a Contracting State within three months from the communication of the mutual agreement that implements the arbitration decision, that he does not accept that mutual agreement, the arbitration decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph."

Austria - Mongolia Income and Capital Tax Treaty (03/07/2003)

"5. If it is not possible for the competent authorities to resolve difficulties or doubts arising as to the interpretation or application of the Convention in course of the mutual agreement procedure according to the preceding paragraphs of this Article within a time limit of two years from the date on which the procedure was initiated, the case shall be presented, upon application of all taxpayers concerned, to an arbitration court by the competent authority of the Contracting State which has initiated the mutual agreement procedure. The arbitration court shall consist of one representative of each competent authority of the Contracting States and of one independent person from each Contracting State who shall be appointed from a list of arbitrators in the order of their ranking. The arbitrators shall elect another person as chairman who must possess the qualifications required for the appointment to the highest judicial offices in his country or be a juriconsult of recognized competence. Each State shall nominate five competent persons for the list of arbitrators. The taxpayer shall be heard before the arbitration court at his request. The arbitration court shall deliver its decision not more than six months from the date on which the matter was referred to it. The decision shall be binding with regard to the individual case on both Contracting States and all taxpayers concerned."

Netherlands - Qatar Income Tax Treaty (24/04/2008)

"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 the person concerned 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."

Some treaties do not contain the rule according to which no arbitration is available if a decision on the issue has been delivered by a court in either State. Example:

Netherlands – United Kingdom Tax Treaty (2008):

"5. Where,

a) under paragraph 1 of this Article, 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 this 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 if the person so requests. 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."

ANNEX 5

ARBITRATION PROVISIONS IN SOCIAL SECURITY TREATIES

Under social security treaties, people who work or have worked for both Contracting States can receive credit for work performed in both States under the social security system of one State. These treaties avoid paying social security taxes to both States.
For example, if an employee works in State X and contributes to the Social Security of that State, and his employer sends him to work temporarily in State Z, a social security treaty between those States enables the employee to:

- continue to contribute to the Social Security of State X while working in that State Z,
- have the periods in State Z considered for purposes of the Social Security of State X (pensions, etc.), and
- be exempt from contributing to the Social Security of the State Z.

Canada - Lithuania Social Security Treaty (05/07/2005)

"1. The competent authorities of the Parties shall resolve, to the extent possible, any difficulties which arise in interpreting or applying this Agreement according to its spirit and fundamental principles.

2. The Parties shall consult promptly at the request of either Party concerning matters which have not been resolved by the competent authorities in accordance with paragraph 1.

3. Any dispute between the Parties concerning the interpretation of this Agreement which has not been resolved or settled by consultation in accordance with paragraph 1 or 2 shall, at the request of either Party, be submitted to arbitration by an arbitral tribunal.

4. Unless the Parties mutually determine otherwise, the arbitral tribunal shall consist of three arbitrators, of whom each Party shall appoint one and the two arbitrators so appointed shall appoint a third who shall act as president; provided that if either Party fails to appoint its arbitrator or if the two arbitrators fail to agree, the competent authority of the other Party shall invite the President of the International Court of Justice to appoint the arbitrator of the first Party or the two appointed arbitrators shall invite the President of the International Court of Justice to appoint the president of the arbitral tribunal.

5. If the President of the International Court of Justice is a citizen of either Party, the function of appointment shall be transferred to the Vice-president or the next most senior member of the Court who is not a citizen of either Party.

6. The arbitral tribunal shall determine its own procedures, but it shall reach its decisions by a majority of votes.

7. The decision of the arbitral tribunal shall be final and binding."

CARICOM Social Security Treaty (01/03/1996)

Antigua and Barbuda, Barbados, Belize, Dominica, Jamaica, St. Lucia, Trinidad and Tobago); 21 March 1996 (Guyana); 6 July 1996 (St. Christopher (St. Kitts) and Nevis); 17 June 1997 (Grenada); 2 July 1997 (St. Vincent and the Grenadines); 27 October 1999 (Bahamas); 27 November 1999 (Montserrat).
Entry into Force: 1 April 1997.

"Article 57
Disputes settlement

1. Any dispute arising between two or more Contracting Parties concerning the interpretation or application of this Agreement shall first be subject to negotiation between the Contracting Parties concerned.

2. Where the dispute is not settled within three months from the request for commencement of negotiations as set out in paragraph 1, the dispute shall be submitted to arbitration on the written request of any of the Contracting Parties. Such request shall be addressed to the Secretary-General who shall promptly notify the parties to the dispute of the receipt of the request for arbitration.

3. Any dispute to be submitted to arbitration shall be referred to a tribunal consisting of three arbitrators. Each party to the dispute shall appoint an arbitrator and the two arbitrators so appoint shall appoint the third arbitrator who shall be the chairman. The chairman must be a person with legal qualifications.

4. For the purpose of appointing a tribunal referred to in the preceding paragraph, a list of arbitrators consisting of persons experienced in the practice of social security shall be drawn up and maintained by the Secretary-General. To this end, every Contracting Party shall be invited to nominate two persons and the names of the persons so nominated shall constitute the list. The term of an arbitrator, including that of any arbitrator nominated to fill a vacancy, shall be three years and may be renewed. The chairman need not be appointed from the list.

5. If within thirty days following the date of notification by the Secretary-General in accordance with paragraph 2 of this Article, either party fails to appoint an arbitrator, any party may request the Secretary-General to appoint the other arbitrator. If within fifteen days of the appointment of the last of the two arbitrators the chairman has not been appointed, either party may request the Secretary-General to appoint the chairman.

6. Where more than two Contracting Parties are parties to a dispute, the parties concerned shall agree among themselves on the arbitrators to be appointed from the list. In the absence of such an appointment within the prescribed period, the Secretary-General shall appoint a sole arbitrator whether from the list or otherwise for the purpose.

7. The arbitral tribunals so established shall make a determination within ninety days from the date of its constitution. The decision of a sole arbitrator or of a majority in other cases shall be accepted by the parties to the dispute as final.

8. The procedure of the tribunal shall be determined by the arbitrators but the chairman shall be empowered to settle all questions of procedure in any case where there is disagreement.

9. The parties to a dispute shall bear the cost of the arbitration equally."

Cyprus - Egypt Social Security Treaty (12/07/1988)

"1. Any dispute between the competent authorities of the two Parties about the interpretation or application of this Agreement shall be resolved through agreement between the competent authorities of each Party.

2. If any such dispute cannot be resolved in this manner, it shall be submitted, at the request of either Party, to an arbitration tribunal which shall be composed in the following manner:

(a) each Party shall appoint an arbitrator within one month from receipt of the demand for arbitration. The two arbitrators shall appoint a third arbitrator, who shall not be a national of either Party, within two months from the date on which the Party, which was the last to appoint its arbitrator has notified the other Party of the appointment;

(b) if within the prescribed period either Party should fail to appoint an arbitrator, the other Party may request the President of the International Court of Justice or, in the event of his having the nationality of one of the Parties, the Vice-President or next senior judge of that Court not having the nationality of either Party, to make the appointment. A similar procedure shall be adopted at the request of either Party, if the two arbitrators cannot agree on the appointment of the third arbitrator.

3. The decision of the arbitration tribunal shall be by majority vote. Its decision shall be binding on both Parties. The costs of the arbitration tribunal shall be borne equally by the two Parties. The arbitration tribunal shall determine its own rules of procedure."

Morocco - Sweden Social Security Treaty (1980)

"Article 31

1. Disputes arising in connection with the application of this Convention shall be settled by mutual agreement between the authorities.

2. Should an agreement fail to materialize, the dispute shall be submitted to arbitration, as defined by mutual agreement between the competent authorities. The arbitration shall take into account the spirit and letter of this Convention."

Arbitration Provisions in Bilateral Investment Treaties

Bilateral Investment treaties are agreements between two countries for the reciprocal promotion and protection of investments in a Contracting state by companies based in another Contracting state. Those treaties typically cover the following areas: scope and definition of investment, admission and establishment, national treatment, most-favoured-nation treatment, fair and equitable treatment, compensation in the event of expropriation or damage to the investment, guarantees of free transfers of funds and dispute settlement mechanisms (both investor-state and state-state).

Bilateral Investment treaties can be found on the website of UNCTAD:
http://www.unctadxi.org/templates/Page 1006.aspx

AGREEMENT' BETWEEN THE GOVERNMENT OF THE REPUBLIC OF INDIA AND THE GOVERNMENT OF THE KINGDOM OF DENMARK CONCERNING THE PROMOTION AND RECIPROCAL PROTECTION OF INVESTMENTS SIGNED ON 6 SEPTEMBER 1995

Article 9
Disputes between a Contracting Party and an investor
(1) Any dispute which may arise between an investor of one Contracting Party and the other Contracting Party in connection with an investment under this Agreement shall, as far as possible, be settled amicably.
(2) If such dispute between an investor of one Contracting Party and the other Contracting Party continues to exist after a period of six months, the investor shall be entitled to submit the case either to the competent judicial or administrative bodies of the Contracting Party in whose territory the investment was made or to international conciliation or arbitration as follows:
(a) to international conciliation under the rules of the United Nations Commission on International Trade Law. If the conciliation proceedings are terminated other than by signing of a settlement agreement, the dispute may be referred to arbitration, either to
(b) the International Centre for Settlement of Investment Disputes established pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of other States opened for signature at Washington D .C. on 18th March 1965 (ICSID Convention),' as soon as both Contracting Parties become Parties to this Convention. In the meantime the dispute may be submitted to the Additional Facility for the Administration of Conciliation, Arbitration and fact-finding Proceedings; or to
(c) an international ad hoc arbitral tribunal established under the Arbitration Rules of the United Nation Commission on International Trade Law, subject to the following modifications:
(i) The appointing authority under Article 7 of the rules shall be the President, the Vice-President or the next senior Judge of the International Court of Justice, who is not a national of either Contracting Party. The third arbitrator shall not be a national of either Contracting Party.
(ii) The parties shall appoint their respective arbitrators within two months.

(iii) The arbitral award shall be made in accordance with the provisions of this Agreement.

(3) The arbitral award shall be final and binding for the parties involved in the dispute, and shall be implemented according to national law.

AGREEMENT BETWEEN THE GOVERNMENT OF THE REPUBLIC OF KOREA AND THE GOVERNMENT OF THE REPUBLIC OF SOUTH AFRICA ON THE PROMOTION AND PROTECTION OF INVESTMENTS SIGNED ON 7 JULY 1995.

ARTICLE 8

Settlement of Investment Disputes between a Contracting Party and an Investor or the other Contracting Party

(1) Any dispute between a Contracting Party and an investor of the other Contracting Party, including expropriation of the investment, shall, as far as possible, be settled by the parties to the dispute in an amicable way.

(2) The local remedies under the laws and regulations of one Contracting Party in the territory of which the investment has been made are available for the investor of the other Contracting Party on the basis of treatment not less favourable than that accorded to investment of its own investors or investors of any third State whichever is more favourable to the investor.

(3) If the dispute cannot thus be settled within six (6) months from the date on which the disputed has been raised by either party, it shall be submitted upon request of either the investor or the Contracting Party to either;

(a) the International Centre for the Settlement of Investment Disputes (ICSID), established pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of other States, opened for signature in Washing D.C. on 18 March 1965; or

(b) an ad hoc arbitral tribunal which, unless otherwise agreed upon by the parties to the dispute, shall be established under the arbitration rules of the United Nations Commission on International Trade Law(UNCITRAL)

(4) For the time being whilst the Republic of South Africa is not a party to the convention referred to in sub-paragraph (a) of paragraph (3), the dispute may be settled under the rules governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes.

(5) The award made by either arbitral tribunal of paragraph (3) shall be final and binding for the parties to the dispute. Each Contracting Party shall ensure the recognition and enforcement of the award in accordance with its relevant laws and regulations.

ARTICLE 9

Settlement of Disputes between the Contracting Parties

(1) Disputes between the Contracting parties concerning the interpretation or application of this Agreement shall, if possible, be settled through consultation or diplomatic channels.

(2) If a dispute cannot be settled within six (6) months, it shall, upon the request of either Contracting Party, be submitted to an Arbitral Tribunal in accordance with the provisions of this Article.

(3) The Arbitral Tribunal shall be constituted for each individual case in the following way, Within two(2) months of the receipt of the request for arbitration, each Contracting Party shall appoint one member of the

Tribunal. These two members shall then select a national of a third State, who on approval of the two Contracting parties shall be appointed Chairman of the Tribunal (hereinafter referred to as the "chairman"). The Chairman shall be appointed within three (3) months from the date of appointment of the other two members.

(4) If within the periods specified in paragraph (3) of this Article the necessary appointments have not been made, a request may be made by either Contracting Party to the president of the International of either Contracting Party or if he is otherwise prevented from discharging the said function, the Vice-President shall be invited to make the appointment. If the Vice-President also happens to be a national of either Contracting Party or is prevented from discharging the said function, the member of the International Court of Justice next in seniority who is not a national of either Contracting Party shall be invited to make the appointments.

(5) The Tribunal shall decide the dispute according to this Agreement and to the principles of international law. The Arbitral Tribunal shall reach its decision by a majority of votes. Such decision shall be binding on both Contracting Parties. Each Contracting Party shall bear the cost of its own arbitrator and its representation in the arbitral proceedings. The costs of the Chairman and the remaining costs shall be borne in equal parts by both Contracting Parties. The Arbitral Tribunal shall determine its own procedure.

ANNEX 6

ANSWERS TO THE QUESTIONNAIRE ON MAP CASES

ANSWERS OF 6 NON-OECD COUNTRIES

1. Number of outstanding MAP cases on 31 December 2009 (or at the end of the taxation year ending in 2009)

1 WITH OECD COUNTRIES	2 WITH NON-OECD COUNTRIES	3 TOTAL (1+2)
64	7	71

2. What was the average period of time (in months) to solve or close MAP cases in which your country was involved for each of the following periods:

	4 WITH OECD COUNTRIES		5 WITH NON-OECD COUNTRIES	
	4.1 NUMBER OF CASES	4.2 AVERAGE NUMBER OF MONTHS BETWEEN OPENING AND CLOSING OF THE CASE	5.1 NUMBER OF CASES	5.2 AVERAGE NUMBER OF MONTHS BETWEEN OPENING AND CLOSING OF THE CASE
Year 2009 (or 2009 taxation year)	19	13.53	6	5.17
2005-2009 five year period (or taxation years 2005 to 2009)	48	13.15	18	8.89

3. How many MAP cases in which your country was involved were closed without a full agreement between the competent authorities of the countries involved for each of the following periods:

	6 NUMBER OF CASES WITH OECD COUNTRIES CLOSED WITHOUT FULL AGREEMENT BETWEEN THE COMPETENT AUTHORITIES	7 NUMBER OF CASES WITH NON-OECD COUNTRIES CLOSED WITHOUT FULL AGREEMENT BETWEEN THE COMPETENT AUTHORITIES
Year 2009 (or 2009 taxation year)	2	0

2005-2009 five year period (or taxation years 2005 to 2009)	8	0

ANSWERS OF 14 OECD COUNTRIES

1. Number of outstanding MAP cases on 31 December 2009 (or at the end of the taxation year ending in 2009)

1 **WITH OECD COUNTRIES**	**2** **WITH NON-OECD COUNTRIES**	**3** **TOTAL** **(1+2)**
2173	196	2363

2. What was the average period of time (in months) to solve or close MAP cases in which your country was involved for each of the following periods:

	4 **WITH OECD COUNTRIES**		**5** **WITH NON-OECD COUNTRIES**	
	4.1 **NUMBER OF CASES**	**4.2** **AVERAGE NUMBER OF MONTHS BETWEEN OPENING AND CLOSING OF THE CASE**	**5.1** **NUMBER OF CASES**	**5.2** **AVERAGE NUMBER OF MONTHS BETWEEN OPENING AND CLOSING OF THE CASE**
Year 2009 (or 2009 taxation year)	762	26.44	26	26.40
2005-2009 five year period (or taxation years 2005 to 2009)	3010	28.22	119	28.45

3. How many MAP cases in which your country was involved were closed without a full agreement between the competent authorities of the countries involved for each of the following periods:

	6 **NUMBER OF CASES WITH OECD COUNTRIES CLOSED WITHOUT FULL AGREEMENT BETWEEN THE COMPETENT AUTHORITIES**	**7** **NUMBER OF CASES WITH NON-OECD COUNTRIES CLOSED WITHOUT FULL AGREEMENT BETWEEN THE COMPETENT AUTHORITIES**
Year 2009 (or 2009 taxation	48	1

year)		
2005-2009 five year period (or taxation years 2005 to 2009)	252	22

ANNEX 7

ARBITRATOR'S FEES

Under the EU Arbitration Convention, EU member States have agreed that unless the concerned states agree otherwise:

- The reimbursement of the expenses of the independent persons of standing will be limited to the reimbursement usual for high ranking civil servants of the Member State which has taken the initiative to establish the arbitration board.
- The fees of the arbitrators will be fixed at EUR 1 000 per person per meeting day of the arbitration board, and the Chairman will receive a fee higher by 10 % than that of the other independent arbitrators.

The United States and Belgium have mutually agreed to share the costs as follows with respect to the so-called "last best offer" arbitration provided for in their Convention:

- The fees and expenses will be borne equally by the Contracting States.
- Neither Contracting State will charge a taxpayer for costs associated with arbitration.
- The fees of members of the arbitration board will be set at the fixed amount of $2000 (two thousand United States dollars) or the equivalent in euro per day, subject to modification by the competent authorities.
- For one case, each board member will be compensated for no more than three days of preparation, for two meeting days (including through video-conference) and for the travel days necessary to attend the meetings. If the board members feel, however, they require additional time to properly consider the case, the board members may be compensated for additional time.
- Each Contracting State pays the member it appointed and pays half of the fees attributable to the Chair.
- In general, the expenses of members of the arbitration board will be set in accordance with the International Centre for Settlement of Investment Disputes (ICSID) Schedule of Fees for arbitrators (as in effect on the date on which the arbitration proceedings begin), subject to modification by the competent authorities.
- Any fees for language translation will be borne equally by the competent authorities.

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