E/C.18/2019/CRP.18

Distr.: General
23 September 2019

Original: English

Committee of Experts on International Cooperation in Tax Matters
Nineteenth session
Geneva, 15-18 October 2019
Item 3 (f) of the provisional agenda
Dispute avoidance and resolution

Preliminary Draft of the Chapters on MAP Arbitration and on Possible Improvements to MAP of the Handbook on Dispute Avoidance and Resolution

Note by the Subcommittee on Dispute Avoidance and Resolution

Summary

This note is presented FOR DISCUSSION (and not for approval) at the nineteenth session of the Committee to be held in Geneva on 15-18 October 2019.

The note includes a preliminary draft of what was initially referred to as Chapter 6 (Non-Binding Dispute Resolution [NBDR] Mechanisms) and Chapter 7 (Mandatory Dispute Settlement [arbitration]) of the proposed *United Nations Handbook on Dispute Avoidance and Resolution.* As explained in paragraphs 4 to 6 of the introductory part of this note, the Subcommittee on Dispute Avoidance and Resolution, at its meeting of 1-3 July 2019, decided to reorganize and rename these two chapters.

The attached preliminary draft of both chapters was prepared on the basis of the discussions at that meeting and is presented to the Committee for a first discussion at its meeting of 15-18 October 2019. During that meeting, the Committee is first invited to confirm its agreement with the Subcommittee's decisions concerning the renaming and scope of the chapters. It is then invited to discuss the attached preliminary draft of the chapters.

Based on the discussion of this note at the Committee's meeting and on written comments, the Subcommittee intends to revise the draft chapters at its meeting scheduled for 12-14 February 2020 and to send it in advance of the Committee's next meeting, when it would be presented for discussion with a view to its approval for inclusion in the *UN Handbook on Dispute Avoidance and Resolution*.

1. Paragraphs 8 and 9 of note E/C.18/2018/CRP.13, which was presented at the seventeenth session of the Committee (Geneva, 16-20 October 2018), described the next steps leading to the finalization of the proposed *United Nations Handbook on Dispute Avoidance and Resolution.*

2. In accordance with the timetable outlined in these paragraphs, the Subcommittee on Dispute Avoidance and Resolution, at its meeting of 1-3 July 2019 held in Warsaw (Poland), finalized the contents of Chapter 3 on Domestic Dispute Resolution Mechanisms (which is presented to the Committee for approval as separate note E/C.18/2019/CRP.17) and discussed a first draft of what was then referred to as Chapter 6 (Non-Binding Dispute Resolution [NBDR] Mechanisms) and Chapter 7 (Mandatory Dispute Settlement [arbitration]).

3. During that meeting, the Subcommittee first discussed the titles and scope of each of these two chapters.

4. In relation to the proposed Chapter 6 (Non-Binding Dispute Resolution [NBDR] Mechanisms), it was noted that the chapter dealt with how the mutual agreement procedure (MAP) could possibly be improved, something that is already addressed in section 5.6 of Chapter 5 (Mutual Agreement Procedure), which was approved by the Committee at its eighteenth session (New York, 23-26 April 2019). It was also noted that the draft chapter presented to the Subcommittee did not discuss an obvious possible improvement to the MAP, which was the provision of technical assistance to developing countries that have little or no experience with MAP cases. For these reasons, it was agreed that the draft chapter should address more generally mechanisms that could possibly improve the MAP process. A third observation was that since the chapter deals primarily with approaches that are not currently used, it should logically follow, rather than precede, the proposed Chapter 7 which deals with MAP arbitration, a mechanism that is already in use by some countries to resolve MAP cases that the competent authorities are unable to resolve within a certain period of time.

5. As regards the titles of both Chapters 6 and 7, it was further noted that the references to "non-binding dispute resolution mechanisms" and "mandatory dispute settlement", as well as their acronyms "NBDR" and "MDS", were potentially confusing and did not correspond to the terminology typically used by tax officials. Since Chapter 7 deals exclusively with MAP arbitration, it was decided to use that expression in its title. Also, given the decision to change the scope of Chapter 6 to cover different possible improvements to the mutual agreement procedure, it was decided to change its title accordingly.

6. The Subcommittee then agreed that since Chapters 5, 6 and 7 dealt exclusively with MAP, it would be logical to divide the proposed *Handbook on Dispute Avoidance and Resolution* in two distinct parts so that:

- Part 1 would focus on tax disputes generally (whether based on domestic law or treaties) and would include the proposed Chapter 1, Introduction and Overview (to be drafted), Chapter 2 on Dispute Avoidance Mechanisms (to be presented for first discussion at the April 2020 meeting of the Committee) as well as Chapter 3 on Domestic Dispute Resolution Mechanisms (note E/C.18/2019/CRP.17, which is presented for final approval at the nineteenth session).
- Part 2 would deal exclusively with the mutual agreement procedure and would include Chapter 5 on MAP (already approved but to be renumbered as Chapter 4), the new Chapter 5 on MAP arbitration (see the attached preliminary draft) and the new Chapter 6 on Possible Improvements to the MAP (see the attached preliminary draft).

7. At its nineteenth session on 15-18 October 2019, the Committee is invited to:

- Decide whether it agrees with the Subcommittee's decisions reflected in paragraphs 4 to 6 above concerning the organization of the Handbook and the scope of the attached two new chapters;
- Discuss the attached preliminary draft of these two chapters, focusing primarily on their respective table of contents in order to identify additional issues that should be addressed in these chapters as well as on the following aspects of the drafts on which the Subcommittee decided to seek guidance from the Committee:
    - *As regards the section on MAP mediation in the draft Chapter 6*, some Subcommittee participants suggested that although there is no previous example where mediation has been used in a MAP, mediation could be suggested as a possible improvement to address some MAP cases. Does the Committee consider that mediation would be helpful in such cases and should therefore be suggested as a possible improvement?
    - *As regards section 6.6.4.5 of the section on MAP mediation in the draft Chapter 6:* should that section include a short description of a country's experience with mediation in the context of domestic dispute resolution? If yes, which country should be referred to (the observer from the United Kingdom having asked that the chapter not refer to the UK experience with domestic mediation since he did not consider that it was not relevant for MAP mediation)?
    - *As regards the BusCo case study in section 6.6.5 of the draft Chapter 6:* Some Subcommittee participants did not support the addition of this case study and a number of substantive issues were raised with different aspects of the case. Also, while the case study was initially divided in three parts included in different sections, a majority of Subcommittee decided to include it in a single section. The Committee is invited to decide whether the case study should be included in the chapter and, if yes, whether and how it should be modified and whether it should be kept where it is or divided in different parts.
- Ask Committee members and country observers wishing to send written comments on the attached preliminary draft to do so by email to the Secretariat at taxcommittee@un.org **before 29 November 2019**.

8. The Committee should note that the Subcommittee did not have time, at its Warsaw meeting, to discuss a large number of written comments related to the attached preliminary draft chapters. These draft chapters should not, therefore, be considered to reflect the views of the Subcommittee.

Next steps

9. Based on the discussion of this note at the Committee's nineteenth session, on previous written comments by Subcommittee members that have not already been discussed and on the written comments that will be received after the meeting, the Subcommittee intends to revise and complete the attached draft chapters at its meeting scheduled for 12-14 February 2020 and to send the revised chapters in advance of the Committee's next meeting, when they would be presented for discussion with a view to their approval for inclusion in the *UN Handbook on Dispute Avoidance and Resolution*.

10. The following is the expected timetable for the presentation to the Committee of the remaining parts of the *Handbook*:

- *April 2020 meeting of the Committee:* Final discussion of the attached Chapter on MAP Arbitration and Chapter on Possible Improvements to the MAP; first discussion of Chapter 2 (Dispute avoidance mechanisms).
- *October 2020 meeting of the Committee:* Final discussion of Chapter 2 (Dispute avoidance mechanisms); first discussion of Chapter 1 (Introduction and overview, which will include remaining parts of what was initially intended to be Chapter 4 on Special issues faced by developing countries) and the Conclusion.
- *April 2021 meeting of the Committee:* Final discussion of Chapter 1 (Introduction and overview) and the Conclusion; approval of the consolidated version of the *Handbook on Dispute Avoidance and Resolution* (subject to changes made to Chapter 1 and the Conclusion during the meeting).

Chapter 5

MAP Arbitration

Table of Contents

5.1 Introduction

1. The previous chapter, which provided a description of the mutual agreement procedure (MAP), did not address the provisions of paragraph 5 of Article 25 (Alternative B) of the UN Model and of Article 25 of the OECD Model, which provide for the mandatory arbitration of issues arising from a MAP request presented under Art. 25(1) that competent authorities are unresolved to resolve within a certain period of time.

2. This chapter examines the use of arbitration as part of the MAP. Today, there are only a relatively small number of countries that use this approach, but with the increased risk of cross-border disputes, as explained in Chapter 1, countries, both individually and collectively, are beginning to show more interest in this approach. This chapter first explains how MAP arbitration works in practice, then examines the different positions that have been put forward concerning its use and finally sets out some design considerations for countries that want to move in this direction.

5.2 Legal Basis

5.2.1 Concept of MAP arbitration

3. Although MAP has generally been successful in resolving the majority of cases brought in countries with an active MAP program,[1] some States have decided to include a mandatory arbitration mechanism in the MAP process.

4. This is done through the adoption of treaty provisions that allow issues that prevent the resolution of MAP cases within a certain period of time to be submitted to one or more independent persons for a decision that both States are bound to follow.[2] This process is referred to as "MAP arbitration" throughout this Chapter.

5. It is important to note that MAP arbitration is fundamentally different from commercial arbitration. While commercial arbitration is an alternative dispute resolution mechanism through which business disputes can independently be resolved, MAP arbitration is merely an extension of the MAP process described in the previous chapter and may be used only where one or more issues arising in a MAP case cannot be resolved by the competent authorities within a prescribed period of time (usually 2 or 3 years).

6. Further, unlike an arbitration award in commercial arbitration that requires enforcement through a court system, MAP arbitration results in a decision that must be implemented by the

1 See OECD, MAP Statistics 2017, available at https://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics.htm.

2 Some tax administrations take the view that Article 25 authorizes their competent authorities to use arbitration on an *ad hoc* basis in particular cases, even if arbitration is not specifically referenced, but this is very rare in practice.

competent authorities themselves. In fact, competent authorities may even be given the discretion to arrive at an agreement different from the decision resulting from the arbitration.[3]

7. Finally, whether initiated by the taxpayer or the competent authorities (depending on the tax treaty provision), arbitration results in a State-State procedure and does not usually directly involve the taxpayer, as in the case of investment arbitration.

8. Therefore, arbitration is prophylactic in nature i.e. it aims to ensure that cases are resolved more efficiently through MAP and, thereby, to avoid having to move into arbitration.[4]

5.2.2 The UN Model Position

9. Article 25 of the UN Model Convention dealing with MAP contains two alternative versions. Alternative A provides only for MAP as described in Chapter 4 of this Handbook. Alternative B, however, includes an additional paragraph 5 according to which issues that are unresolved through MAP may be submitted to arbitration.

10. Per this provision, where the competent authorities of two States are unable to reach an agreement to resolve a case through MAP within 3 years from the presentation of the MAP case to the competent authority of the other State following a MAP request, unresolved issues may be submitted to arbitration at the request of either competent authority.[5]

11. However, issues that have been finally decided by a Court or Tribunal in either State cannot be submitted to arbitration. Once arbitration is initiated, the taxpayer involved in the MAP case should be notified.

12. Further, the competent authorities may agree on a different decision within six months of the decision. However, the taxpayer may choose not to accept the decision. Following the 6-month period and acceptance of the taxpayer, the decision would be binding on both competent authorities to implement through MAP, irrespective of domestic time-limits.

13. The competent authorities have been given discretion as regards the procedure to adopt for arbitration under this provision. The UN Model Commentary on Article 25 gives some additional guidance that States may choose to follow, specifically through a "sample mutual agreement" that States may use as a format to implement Article 25(5). This "sample agreement" proposes comprehensive rules as regards the type of arbitration procedure, selection of arbitrators, independence and transparency rules, remuneration of arbitrators,

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3 See Alternative B, Article 25, UN Model Convention (2011); Para 84, Commentary to Article 25, OECD Model Convention (2014).

4 Para 64, OECD Model Commentary on Article 25, referred to in the UN Model Commentary on Article 25; H.J. Ault & J. Sasseville, 2008 OECD Model : the new arbitration provision, 63 Bull. Intl. Taxn. 5 (2009), Journals IBFD.

5 However, Paragraph 17 of the UN Model Commentary on Article 25 allows States to draft this provision in such a way that the affected taxpayer and not the competent authorities may make this request for arbitration.

costs, procedural and evidentiary rules, sharing of information and confidentiality rules and implementation/enforcement related rules.

14. The Commentaries also provide additional guidance on the relationship between the arbitration process and domestic remedies. Given that issues that have already been decided by a Court or Tribunal in either State may not be submitted to arbitration, the taxpayer may have to suspend its right to domestic law remedies on the concerned issue in order to pursue arbitration. Most States consider it impractical to allow parallel pursuit of arbitration and domestic law remedies.

15. Therefore, States may require that if a taxpayer has made use of domestic remedies and a decision has not yet been reached by the courts or administrative tribunals, it has to put the procedure on hold until the arbitration has been completed in order to prevent an abrupt termination of proceedings due to the issuance of the court decision. Although some States have raised constitutional or other legal restrictions in this regard, in other States, it may be possible to require the taxpayer to renounce the right to a domestic law remedy.

16. In States where the competent authorities can deviate from a final Court decision, it is not necessary to force the taxpayer to choose between domestic and treaty remedies.[6]

5.2.3 The OECD and MLI Positions

17. Article 25(5) of the OECD Model Convention is largely similar to Article 25(5) in Alternative B of Article 25 of the UN Model Convention.

18. However, there are some significant differences. First, the OECD Model Convention does not contain two alternatives – the Model generally prescribes the inclusion of arbitration provisions.[7] Second, the OECD Model Convention allows for arbitration when a case is unresolved through MAP for 2 years, rather than the 3-year period in the UN Model Convention. Third, the OECD Model Convention allows for the arbitration request to be made by the affected taxpayer and not one of the competent authorities. Fourth, the OECD Model Convention does not allow for competent authorities to adopt an agreement different from the arbitration decision within 6 months.[8] Guidance on the conduct of arbitration is provided for in the OECD Model Commentaries as well, a large part of which has been referred to in the UN Model Commentary on Article 25.

19. The treaty-based changes proposed by the BEPS project have been implemented through a multilateral instrument (MLI). The MLI is a multilateral treaty under public international law with its own direct effect, but it only stands to modify only the application of

6 See UN Model Commentaries on Article 25 (2011).

7 It should be noted that among OECD Member Countries, only Chile and Hungary have reserved the right not to include arbitration. Other countries that have noted their position not to include arbitration are: Brazil, India, Indonesia, China, Serbia, South Africa and Hong Kong, China. However, some OECD Member States have not accepted the arbitration provision in Part VI of the MLI.

8 However, the possibility to do this is highlighted in the Commentaries. *See* Para 84, Commentary to Article 25 of the OECD Model Convention.

bilateral treaties between the parties to the MLI. Accordingly, the text of the MLI was adopted on 24-25 November 2016 and since the first signing ceremony on 7 June 2017, as of 1 August 2017, 70 jurisdictions have signed the MLI and have already begun the ratification process.

20. The MLI contains an option for mandatory binding arbitration in Part VI. This option is more detailed than the provisions in the Model Conventions since detailed rules have been added in the provision itself on access to arbitration, information requests and timelines, appointment of arbitrators and costs, mode of conduct of arbitration, independence, transparency and confidentiality rules.[9]

5.3 Different views of the appropriateness of arbitration

21. Countries hold different views on the need for arbitration in the context of MAP, partly reflecting their own economic, social, and legal environment and partly reflecting their experience with existing economic dispute resolution mechanisms in tax and non-tax agreements. The views of countries are also influenced by the capacity to engage in what is sometimes perceived as a complex process. This section sets out the views that have been expressed on the need and desirability of arbitration in the context of MAP.

5.3.1 The perceived concerns

22. Several concerns raised primarily by developing countries during discussions at the Committee level have been recorded in the UN Model Commentaries.[10] These concerns include possible sovereignty and constitutionality concerns, costs and lack of resources, even-handedness in the process, lack of experience and familiarity with MAP and arbitration, transparency and reviewability and enforceability.[11]

23. These States are of the view that arbitration in tax treaty disputes affects their sovereignty. Some States consider the inclusion of arbitration of a tax dispute "unconstitutional". Some other States consider that the inclusion of arbitration, whilst constitutional, may create other constitutional obligations such as extension of such remedies in domestic cases. Other States that do not have the above concerns have raised the issue of shifting of decision-making power from the State to members of an arbitration panel. On the other hand, other States have taken the view that legal and constitutional concerns should not

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9 There are also rules for arbitration in tax treaty matters within the European Union. The EU *Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises* (see https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:41990A0436&from=en, as subsequently amended) provides for arbitration that is triggered if MAP is unsuccessful for 2 years, much like under the OECD Model Convention. A new directive to govern cross-border dispute resolution through instruments such as the Arbitration Convention and tax treaties has also been adopted in the EU in 2017 (see Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union, available at https://eur-lex.europa.eu/eli/dir/2017/1852/oj).

10 Paragraph 4 of the Commentary on Article 25 of the UN Model (2011).

11 Commentary on Article 25 UN Model, paragraphs 4 and 5; UN, "Secretariat Paper on Alternative Dispute Resolution in Taxation', E/C.18/2015/CRP.8, October 8, 2015, available at: http://www.un.org/esa/ffd/wp-content/uploads/2015/10/11STM_CRP8_DisputeResolution.pdf.

arise in arbitration since sovereignty is legally ceded to the extent of the tax treaty and the dispute resolution mechanism in a treaty merely enforces such provisions. Some States also rely on their experience with arbitration and mandatory dispute settlement in treaties in other areas such as trade and investment to argue that sovereignty concerns should not arise.

24. Some States have also raised concerns as regards costs. Arbitration necessarily entails costs in terms of fees for the arbitrators, facilities and additional fees for counsel/representation where needed. Also, developing countries may be concerned that these fees could be payable in a foreign currency on a scale that is not proportional to the resources available to them. There may also be concerns by developing countries that they may need to hire outside experts to assist them in a MAP arbitration process, although previous MAP arbitration cases suggest that this would not be necessary. On the other hand, other States believe that the costs associated with arbitration may be lower than expected owing to the limited number of cases that may go to arbitration and the ability to structure an efficient arbitration process and to put a cap on the compensation of arbitrators (e.g. as is sometimes done with the last-best-offer form of arbitration).

25. Several developing countries have also raised concerns as regards their perceived lack of experience in arbitration as compared to developed countries. This may put undue pressure on the competent authorities of developing countries. Some developed countries, however, have claimed that impartial decisions by arbitrators from all backgrounds, including from developing countries, may help overcome lack of experience of developing countries.

26. A number of officials from developing countries do not rule out an eventual recourse to MAP arbitration but consider that they are not yet ready for such a mechanism, especially given the negative experience of some developing countries with the application to tax measures of the arbitration provisions of bilateral investment agreements. They also note that, in the current environment, most MAP arbitration cases that would involve developing countries would focus on tax collected by these countries' as opposed to tax collected by developed countries.

27. Some States believe that arbitration may also lead to concerns of even-handedness. They consider that, as of today, there is only a small pool of possible arbitrators who can deal with complex international tax and transfer pricing issues and most of them come from the developed world. Although this group may include academics and people having no affiliation with governments or business, these States claim that their thought process and understanding of international taxation may be tuned to the developed world and might not be familiar with concerns of developing countries. There are also concerns that few potential arbitrators would be fluent with the official languages of some developing countries, which might make it difficult for these arbitrators to fully understand the position of the competent authorities of these countries.

28. Some States are of the view that tax treaty arbitration may also raise concerns of transparency, although such concerns would seem to be applicable to all MAP cases, whether or not they involve arbitration. Like other parts of the MAP process, MAP arbitration

proceedings are generally considered confidential and opinions are not published. Further, in mandatory binding arbitration in tax treaties, decisions are considered binding on the competent authorities (even though they have no precedential value for other cases).

5.3.2 The perceived benefits

29. Arbitration may be considered appropriate by countries concerned that there is no assurance that MAP will be able to resolve all disputes and where there is a feeling that MAP not being time-bound has resulted in disputes not being resolved, or taking too long to resolve. The UN Model Commentaries, based on the discussions by the Committee, have noted some perceived benefits in relation to introduction of arbitration in the context of MAP. [12]

30. The most significant benefit perceived by some States in adding arbitration to the MAP process is the "prophylactic effect". Since the purpose of arbitration would not be to replace the MAP with an independent evaluation of the case by arbitration, but to encourage resolutions in MAP and improve the current MAP process in those few cases where the competent authorities are unable to agree on a resolution, such States claim that the inclusion of arbitration would encourage the competent authorities to conclude more cases under MAP in an efficient manner. In practice, this has been the experience under the Canada-United States tax treaty, which has included mandatory binding arbitration since 2010.

31. Some States are also of the view that including arbitration in their tax treaties to improve the MAP process would be a step forward in guaranteeing to the taxpayer relief from double taxation or taxation not in accordance with the treaty. Although there may only be a few cases that remain unresolved by MAP between the particular States concerned, such States emphasize the importance of resolving MAP issues in such cases as well.

32. States have also taken the view that arbitration in the context of MAP may provide more certainty to taxpayers. Since MAP may not guarantee a resolution, adding arbitration to the MAP process may increase the certainty that a taxpayer feels as regards conclusion of the MAP and eventual resolution of double taxation or taxation not in accordance with the treaty. These states also believe that this will boost cross-border investment. It has also been suggested that the addition of arbitration to a tax treaty may make it easier for a developed country to agree to the addition of controversial provisions to the allocative rules of a tax treaty, especially when the practical application of such provisions is likely to create uncertainty.

33. Some States have also opined that arbitration would help reinforce taxpayer faith in applying the MAP, thereby reducing reliance on sometimes inefficient and unilateral domestic remedies. The alternative for the taxpayer to take the case to Court may not be the best solution for the tax administration either since it might be more cost efficient for the tax administration to go for arbitration as opposed to prolonged judicial processes.

12 Paragraph 5 of the Commentary on Article 25 of the UN Model.

5.4 Procedural guidelines for the implementation of arbitration by opting countries

5.4.1 General overview

34. In general, for countries opting for arbitration, the competent authorities are free to design procedural rules as regards conduct of proceedings under the arbitration clause. As endorsed by the model Conventions and the MLI, competent authorities may enter into, and will need to in order to practically implement arbitration, a competent authority agreement as regards such proceedings. However, since procedural rules may not just directly impact the effectiveness of the provision, but also play a key role in alleviating the concerns described above as regards arbitration, a state should pay careful attention to the procedural rules prescribed in each of its treaties that allows for arbitration.

35. Although the need for flexibility explains the variations of treaty provisions related to arbitration, a country should seek to ensure that the rules governing arbitration in its different treaties are clear, are suitable for all cases where arbitration may be used and are fairly consistent in order to facilitate the understanding of these rules by taxpayers and facilitate the training of tax officials involved in the MAP process.

5.4.2 Initiation of arbitration

36. The Model Conventions differ as regards responsibility for initiating arbitration. While the UN Model Convention prescribes that the competent authority of one of the Contracting States has to make the request for arbitration, the OECD Model Convention and the MLI allow the taxpayer to directly make the request. Countries that otherwise wish to incorporate arbitration within their tax treaties, but feel that allowing the taxpayer to trigger a third-party decision on a tax dispute directly could infringe their sovereignty may consider limiting access only to a competent authority as prescribed in the UN Model Convention. However, since the taxpayer has the right to not accept the final arbitration decision, competent authorities may wish to also ensure the taxpayer's consent before engaging in arbitration.

37. Certain rules as regards the arbitration request should be prescribed in the competent authority agreement. Ideally, the request for initiating arbitration process must be made in writing and should contain all information that is necessary to clearly identify the case. Where a competent authority is allowed to and wishes to initiate arbitration, it must communicate the same to the other competent authority and to the person who has presented the MAP case. Where a taxpayer is allowed to and wishes to initiate arbitration, the competent authority receiving the request should, within a reasonable period of time, also share such request with the other competent authority to formally initiate the process.

38. Where there is a limitation as to the cases that may be submitted to arbitration, such as where arbitration is restricted to certain types of cases or where issues that are subject to a final decision by a Court are excluded from arbitration, the taxpayer may be asked to provide a declaration stating that the case falls within the accepted criteria.

39. While Art. 25(5) Alternative B of the UN Model provides that arbitration must be requested by one of the competent authorities, paragraph 17 of the Commentary on that paragraph provides that State may agree that arbitration may be requested by the person who presented the MAP case. Where the taxpayer is allowed to make the request, it would seem possible present that request to either competent authority, although the States may require that the request be presented to the competent authority of the State to which the MAP case was initially presented under Art. 25(1). Such a requirement should be clearly stated in the applicable treaty or the agreement setting up the arbitration process.

40. Under the MLI and the sample mutual agreement included in the Commentary on the UN and OECD models, if information required by either competent authority pursuant to its published MAP procedures has not been provided by the taxpayer in a timely manner, this delays the start time of the two-year or three-year period during which the case is not eligible for arbitration.

5.4.3 Terms of Reference

41. "Terms of Reference" refers to the questions that must be decided by the arbitration panel in a specific case submitted to arbitration. Although the "arbitration" provisions in the Model Conventions are silent as regards "Terms of Reference", it may be important to refer to them in a competent authority agreement. Following the Sample Mutual Agreement in the UN Model Commentaries, within three months from receipt of the arbitration request by the second competent authority (as determined by agreement), the competent authorities may decide the "Terms of Reference". This time period is reduced to 60 days in the Commentary on Article 25 of the OECD Model.

42. The "Terms of Reference" would determine the jurisdictional basis of a particular case that is subject to arbitration. Where competent authorities make the request, they could determine whether to restrict the process to certain issues. However, where the taxpayer makes the request, the main issues dealt with in the request should ideally be covered in the "Terms of Reference".

43. However, the decision regarding scope should ideally be reflected in the convention or an accompanying agreement so as to prevent an impasse between the competent authorities in this regard.

44. Separate rules may be laid out for failure to communicate the terms of reference as well. If the Terms of Reference have not been agreed by the competent authorities and communicated to the person who has presented the case within three months, the competent authority agreement may allow each competent authority to, within one month after the end of the three month period, communicate in writing to each other a list of issues to be resolved by the arbitration, which may then constitute the tentative Terms of Reference. Within one month after all the arbitrators have been appointed, the arbitrators may then communicate to the competent authorities and the person who presented the case a revised version of the tentative Terms of Reference, which shall become final. Within another one month period, the

competent authorities may also be provided 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, which shall become final.

5.4.4 Selection of the arbitration panel

45. The arbitration panel must be chosen prudently by States opting for arbitration. It is of paramount importance that States carefully select the persons on the Panel both with respect to their experience and qualifications and with respect to their independence and freedom from bias.

46. Rules with regard to selection of the settlement authority may be included either in the arbitration provision in the tax treaty directly or in the competent authority agreement. States have several options as regards the design of such rules.

47. The sample mutual agreement in the UN Model Commentaries suggests a structure for a 3-member panel. This provision suggests that within either a) 3 months from notification of the taxpayer of the Terms of Reference or b) 4 months from when the other competent authority receives the arbitration request filed by one competent authority where Terms of Reference have not been finalized, each competent authority shall appoint one arbitrator. Within two months of the last appointment, the two appointed arbitrators shall appoint the third arbitrator, who shall act as the "Chair". A similar approach is followed in the sample mutual agreement in the OECD Model Commentaries.

48. However, the Model Commentaries differ in situations where there is no appointment, either by the competent authorities for the first two arbitrators or by the arbitrators for the third arbitrator. Per the UN Model Commentaries, if no appointment is made as per this process within the prescribed time-period, the chair of the UN Committee of Experts on International Cooperation in Tax Matters shall make the appointment within 10 days from a request. If such chair is a national of either State involved, the longest serving Committee member who is not a national shall make the appointment. The power of appointment in case of default is provided instead to the highest ranking official of the OECD Centre for Tax Policy and Administration that is not a national of either State involved. The MLI provision follows the same format as the OECD Model Commentaries.

49. States are free to depart from these rules to create customized arbitration panels. For instance, a single arbitrator or a five member panel may also be prescribed. However, States are urged to use an odd number of members in the arbitration panel to avoid having a tie of votes. States may also wish to have different rules to address cases where there is a failure to appoint one or more arbitrators (for instance, where one country wishes to follow the approach suggested in the Commentary on the OECD Model while the other prefers the approach put forward in the Commentary on the UN Model).

50. States may also consider other approaches based on their own policy goals when devising such rules. For instance, paragraph 15 of the Annex to the Commentary on Article 25

UN Model considers the creation of a list of suitable potential arbitrators by the UN Committee of Experts on International Co-operation in Tax Matters.[13] States may accordingly agree on a list of potential arbitrators from which arbitrators may be chosen for each arbitration case arising out of their tax treaty.

51. Specific rules may also be created with respect to replacement of arbitrators. Such a process may be initiated in cases of incapacity, disqualification or resignation. However, in order to avoid undue delay, States may consider allowing replacement of only arbitrators who have been found to be compromised, retaining the rest of the Panel. Ideally, replacement of arbitrators should be made by the remaining members of the Panel by unanimous decision. The replacement of arbitrators may also lead to extension of any timelines that are prescribed for the completion of the process in the treaty provision or the competent authority agreement.

52. Each arbitrator must be qualified to serve in such position. The arbitration provision or agreement may stipulate that arbitrators should be persons with recognized competence in the fields of international tax law who may be relied upon to exercise independent judgment in the area of tax treaty disputes.[14] States may also consider selecting multiple potential arbitrators and agreeing on a list of arbitrators that may be called upon in respect of each treaty.

53. Each arbitrator must be independent. The sample mutual agreement in the UN Model Commentaries suggests that any person including government officials of either State involved may be an arbitrator unless they were themselves involved in the particular case beforehand. The OECD Model Commentaries provide for the same. However, the UN Model Commentaries also suggest that the arbitrator provide a written statement (or an affidavit) that states his impartiality or neutrality, which is not provided for in the OECD Model Commentaries.

54. The MLI provides that each arbitrator should be "impartial" and "independent" of the tax authorities, the competent authorities and the ministry of finance of each State and of all persons affected by the issue at the time of appointment and that they should maintain that status throughout the arbitral process and for a reasonable time thereafter.

55. States may consider these options and agree on independence and transparency rules as regards the arbitrators. However, it may be in the interest of States also to require a written declaration as suggested in the UN Model Commentaries to ensure neutrality and independence.[15] States may consider using the following format for the declaration:

13 Similarly, the approach adopted under the EU Arbitration Convention and the EU Dispute Resolution Directive (see note 9) involves the maintenance of a panel of "independent persons" as well as detailed rules regarding the selection of the Chair.

14 Adapted from Section 14(1), ICSID.

15 This mechanism is also used in ICSID as regards arbitrator independence.

DECLARATION BY ARBITRATOR

"To the best of my knowledge there is no reason why I should not serve on the arbitration panel constituted by [____] with respect to a dispute between _____ and _____, due to conflict of interest arising from any previous relation with either of the parties or jurisdictions involved. I shall keep confidential all information coming to my knowledge as a result of my participation in this proceeding, as well as the contents of any decision delivered by the Panel. I shall judge fairly as between the parties, according to the applicable law, and shall not accept any instruction or compensation with regard to the proceeding from any source except as allowed by the law and Rules made pursuant thereto. I shall also not indulge in any *ex parte* discussions with any of the parties as regards the matter and all questions that I make to the competent authorities shall be in writing with copies shared simultaneously with the other parties.

Attached is a statement of (a) my past and present professional, business and other relationships (if any) with the parties and (b) any other circumstance that might cause my reliability for independent judgment to be questioned by a party. I acknowledge that by signing this declaration, I assume a continuing obligation promptly to notify both parties of any such relationship or circumstance that subsequently arises during this proceeding."

(source: Rule 6(2), ICSID Rules Of Procedure For Arbitration Proceedings)

56. Either competent authority may propose disqualification of an arbitrator if the above conditions are not fulfilled. If such request is made by a competent authority, the other members of the panel should, after giving an opportunity of hearing to the impugned member, decide on this issue by unanimous decision (in case of three member panels) or majority vote (in case of larger panels). If the Panel disqualifies the arbitrator, the procedure applicable to replacement discussed above should be activated.

57. All official communications amongst the Panel and between the Panel and competent authorities and/or the taxpayer should ensure confidentiality.

5.4.5 The arbitration process

58. States opting for arbitration may also decide on the type of arbitration process that should be followed in either the provision itself or the competent authority agreement. Arbitration may be done in many different ways such as "independent opinion" arbitration where consideration of facts, appreciation of evidence and review of the legal position involved are expected from the arbitral panel before arriving at a reasoned decision, "last best offer" or "baseball" arbitration where both competent authorities are required to propose their most reasonable solution to the case and the arbitral panel is bound to choose one of these proposed resolutions as a solution to resolve the case.

59. The "sample" mutual agreement in both the UN and OECD Model Commentaries endorses the use of the "last best offer" or "baseball" arbitration approach. Within 2 months

from the appointment of all arbitrators, each competent authority should present its proposed resolution and a decision shall be delivered by the panel within 3 months from thereon.[16]

60. The MLI allows jurisdictions the option to choose either approach or to create customized rules for each dispute.

61. Specific rules may be required as regards the "last best offer" approach. The proposed resolution should ideally be limited to a disposition of specific monetary amounts or the maximum tax rate applicable, depending on the transaction. Where substantive issues are pending as well (for example, whether a permanent establishment exists), the competent authorities may give alternative proposed resolutions for either result. Competent authorities may also provide supporting position papers to which replies may be provided by the other competent authority. However, page limits may be set for the proposed resolutions, position papers and replies to ensure that this method works in an efficient and time-sensitive manner.[17]

62. Similarly, specific rules may be prescribed as regards the "independent opinion" approach as well. Within a reasonable time period agreed to by both States, each competent authority should provide the Panel with a description of the facts and of the unresolved issues to be decided together with the position of the competent authority concerning these issues and the arguments supporting that position. Competent authorities may also restrict the Panel from considering arguments that were not placed before it by them.

63. Where one competent authority fails to submit a proposed resolution or a position paper, the arbitration decision would follow the other side's proposal. States may also prescribe strict time-limits within which each step of this process should be completed.

64. States should weigh the pros and cons of each approach before making a choice of arbitration process in their tax treaties. In general, the "baseball" approach may be simpler to implement for developing countries. However, independent opinion may be a more familiar procedure, as it resembles a court-like hearing, and would lead to a reasoned decision by the arbitral panel. In practice, States also have the option of adopting the approach best suited to the facts and circumstances of each case.

65. States may also prescribe rules related to the conduct of the arbitration proceedings. The treaty provision or the competent authority agreement may require the Panel to meet within a reasonable time from its creation and may require further meetings within particular time periods. The meetings of the Panel may be done by video-conference or tele-conference as well. Rules may be prescribed as regards the language to be used in such proceedings as well.

66. Neither the OECD nor the UN Model Convention prescribes a specific timeline within which the arbitration process should be completed. However, the sample mutual agreements provide for timelines. The UN sample mutual agreement provides that the decision should be

16 Annex, UN Model Commentaries on Article 25 (2011).

17 Rule 9, Memorandum of Understanding Between the Competent Authorities of Canada and the United States of America.

communicated to both competent authorities within three months from having received the last reply from the competent authorities under the baseball approach. Under the alternative independent opinion approach, the UN sample mutual agreement provides that the decision should be communicated within six months from the date on which the Chair notifies that necessary information has been received.[18] However, the OECD sample mutual agreement provides that the decision should be communicated to both competent authorities within 60 days after the reception by the arbitrators of the last reply submission or, if no reply submission has been submitted, within 150 days after the appointment of the Chair of the arbitration panel (under the baseball approach) and within 365 days from the appointment of the Chair (under the independent opinion approach). Countries should keep timelines in mind if they are looking at MAP arbitration to be a "speedy" solution.

67. Separately, the EU Arbitration Convention and Directive directly provide for legally enforceable timelines within which a decision is to be delivered by the panel and even make remedies available against inaction in domestic Courts at most stages of the process. The arbitration provision in the treaties of the US also contain "default" rules intended to address inaction for each step. States may also draw reference from these practices if they find it in their interest.

68. Countries should generally be free to mutually agree on a place where arbitration proceedings may be conducted. With baseball style arbitration, a physical meeting may not be necessary. Countries entering into arbitration clauses with developing countries should be cognizant of choosing a location that is least draining on the resources of such countries. Further, countries are free to explore the use of technology such as video conferencing for the conduct of arbitral proceedings which may be a speedy and cost-effective solution.

69. Further, the sample mutual agreements in both the UN and the OECD Model Commentaries suggest that the competent authority to which the case giving rise to the arbitration was initially presented should 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. However, if one country disproportionately raises more adjustments than the other country (typically the source country will raise more adjustments),

18 Para 11 of the UN Sample Mutual Agreement also provides that: "If 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

- 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
- 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."

countries may consider adopting a rule to provide for alternating the responsibility for the logistical arrangements.

70. Neither the UN Model Convention nor the OECD Model Convention specifically allows for taxpayer participation in the arbitration process. While the sample mutual agreement in the OECD Model Commentaries allows participation by the person requesting the arbitration process in writing to the extent allowed in MAP and orally if allowed by the panel, the UN Model Commentaries do not provide for this since arbitration may only be requested by the competent authorities in the UN Model Convention provision. The MLI, however, does not provide for taxpayer participation.

71. States may also agree to add any other procedural or evidentiary rules that they may deem fit. For example, States may bilaterally agree on a list of documents that may be accepted as evidence by the Panel while making its decision.

5.4.6 Confidentiality

72. Since arbitration proceedings involve third parties receiving information, it is important to ensure the confidentiality of taxpayer information and the impartiality and independence of the procedure. The sample mutual agreements in both the UN and the OECD Model Commentaries provide that both States should agree that arbitrators appointed would be deemed to be authorized representatives of the appointing parties as regards communications and the confidentiality of information provided. The MLI adds another layer of protection by increasing the number of persons subject to confidentiality requirements: it provides that not only the arbitrators will constitute authorized representatives, but also their support staff (up to 3 staff members per arbitrator). It also requires a written statement as regards confidentiality and non-disclosure obligations from each arbitrator and designated staff member.

73. States may require arbitrators, prior to acting in such position, to declare in writing that they are subject to the relevant confidentiality provisions in the tax treaty and applicable domestic laws. Any staff members used for the Panel process may be required to execute the same declaration. States may also require arbitrators and staff members to destroy all information obtained by them once the arbitral process has concluded.

74. States should also put in necessary rules to ensure that all exchange of information between the competent authorities and the Panel are through secure, encrypted channels to ensure that confidential and sensitive taxpayer information remains protected.

5.4.7 Remuneration of arbitrators and costs involved

75. States must take into account the costs involved in the arbitration process and provide rules for allocating the same to ensure its efficient implementation. Arbitration would necessarily entail some costs in terms of fees for the arbitrators and facilities.

76. As regards costs, both the OECD and UN Model Commentaries provide the following guidelines:

- Each competent authority bears all costs, including travel costs, related to its own participation and in relation to the arbitrator appointed by it or on its behalf by someone else.
- Costs related to the meetings of the panel and the personnel necessary for the process will be borne by the competent authority to which the case giving rise to the arbitration was initially presented.[19]
- All costs in relation to other arbitrators and all other costs will be borne equally by the two States.

77. The MLI only prescribes a specific mutual agreement between the States on costs and if there is no agreement, each party bearing its own costs with shared costs being split equally.

78. Competent authorities may also agree a simpler split of all expenses including arbitrator remunerations *in toto*. States may also bilaterally agree on a separate means for remuneration of arbitrators and provide exact remunerations or remuneration schedules for arbitrators.

79. The Sample Mutual Agreement in the UN Model Commentaries, provides some suggestions to make the remuneration of arbitrators cost-effective. It suggests paying the arbitrators a bilaterally agreed hourly fee which is restricted to 3 days of preparation, 2 meeting days (including video-conferencing) and necessary travel days. Reasonable expenses shall also be reimbursed per this model.

80. Further, where there is a clear disparity in financial status between the two States involved in a tax treaty, it may be appropriate for the States to agree that the better off State would bear more of the costs of the arbitration procedure.

5.4.8 The decision

81. States should provide details with regard to the decision making process. In a panel with three arbitrators, a decision by simple majority may be preferred.

82. States should clarify the criteria that the Panel must apply to arrive at a decision. The Panel should decide the issues submitted to arbitration in accordance with the applicable provisions of the tax treaty, and applicable domestic laws of the States involved. States may also allow the Panel to consider any other sources which the competent authorities of the Contracting Jurisdictions may by mutual agreement expressly identify, or which may be identified by the applicable treaty or accompanying bilateral agreements.

83. States should clarify whether arbitral decisions should be published or not. The sample mutual agreements in the UN Model Commentaries do not, by default, refer to the possibility of publication of decisions made through arbitration since the UN Model Convention follows the "baseball" approach. However, it follows the approach adopted in the OECD Model Commentaries if the "independent opinion" approach is chosen. The sample mutual agreement

19 If presented in both States, the costs will be shared equally.

in the OECD Model Convention allows publication if agreed to by the person making the request and both competent authorities with redacted details on the understanding that these decisions would carry no precedential value. A similar approach for redacted publication is allowed under the EU directive as well, however, without the requirement for permission of the parties involved. However, the MLI does not specifically allow the publication of decisions even in the "independent opinion" approach.

84. Both the Commentary on the UN Model and the Commentary on the OECD Model suggest that arbitral decisions will not have precedential value. States that wish to provide otherwise would need to make this clear in their agreement.

85. States may allow the competent authorities to arrive at a different resolution in the treaty. The treaty itself may clarify that the competent authorities may resolve the case while the arbitral proceedings are pending, leading to the withdrawal of the arbitration request.

86. Both the UN and OECD Model Conventions provide that the arbitral decision shall be final and binding on the competent authorities to implement through a MAP agreement, unless the taxpayer rejects the decision. However, the UN Model Convention also allows the competent authorities the opportunity to arrive at an agreement that is different to the decision within 6 months, after which time the decision is final. In practice, this is likely to be more relevant for independent opinion, rather than baseball arbitration.

Chapter 6

Possible improvements to MAP

Table of Contents

6.1 Introduction

1. A country that concludes a tax treaty that includes provisions based on those of Art. 25 of the UN or OECD Model has a legal obligation to endeavor to resolve through MAP any admissible case presented to its competent authority under Art. 25(1). Many developing countries, however, have no or little experience with MAP and may therefore need assistance in dealing with MAP cases, which requires not only a good understanding of the MAP process but also of treaty provisions and transfer pricing principles. Even countries with significant MAP caseloads may experience difficulties in solving MAP cases with some of their treaty partners.

2. This chapter examines measures that could possibly improve MAP in these and other cases. Some of these measures have already been used to a limited extent while others have yet to be used.

3. Section 6.2 deals with the provision of technical assistance to a country with respect to one or more specific MAP cases under a program such as the Tax Inspectors Without Borders (TIWB). Section 6.3 refers to capacity-building efforts intended to improve the capacity of developing countries to meet their MAP obligations. Section 6.4**Error! Reference source not found.** describes how the conclusion of "framework agreements" may help address some of the difficulties that the competent authorities of two countries encounter in dealing with their mutual MAP caseload. Section 6.5 examines how new technologies may facilitate the MAP process. Section 6.6 discusses the possible use of non-binding dispute resolution mechanisms in order to resolve MAP cases.[1]

6.2 Technical assistance with respect to specific MAP cases

4. The competent authority of a country that has no or little MAP experience and that is faced with a MAP request could benefit from the assistance of persons who have expertise of the MAP process and of the relevant treaty provisions.

5. Obviously, few developing countries would be in a position to pay consultants for that purpose. Also, MAP experience is primarily gained through work within the competent authority team of a tax administration. For these reasons, the type of case-specific MAP assistance that would likely be needed by the competent authority of a developing country would seem to be similar to the kind of assistance that is provided to the tax auditors of developing countries' tax administrations under the Tax Inspectors Without Borders (TIWB) program (see box 1 below).

1 While it has also been suggested that MAP could be improved if a taxpayer could, if both competent authorities agreed in a specific case, access arbitration before the end of the two-year or three-year period provided respectively in Art. 25(5) OECD Model and Art. 25(5) alternative B UN Model, this chapter does not address possible improvements that could result from changing some of the rules applicable to arbitration.

6. The TIWB program, which promotes hands-on assistance by sending experts to build developing countries' audit and audit-related skills pertaining to specific international tax matters, could be expanded (or a similar program could be set up) in order to allow the competent authorities of developing countries to benefit from the assistance of former tax officials familiar with the MAP process and the different types of treaty disputes that are typically dealt through that process. Since the TIWB has already developed mechanisms that ensure the respect of confidentiality requirements applicable to the audit function, the same form of assistance could be provided with respect to MAP cases without breaching the similar confidentiality requirements that apply to the MAP process under tax treaties and domestic law.

Box 1. Tax Inspectors Without Borders

Tax Inspectors Without Borders (TIWB) was launched as a joint UNDP and OECD initiative in July 2015, to support countries to build tax audit capacity.

The 2015 Addis Ababa Action Agenda recognized the need to mobilise more domestic resources for development. For many developing countries, this implies strengthening tax and other revenue collection capacities. TIWB was identified as one of the tools to support developing countries to build the capacities of national tax administration and mobilise more domestic revenues for the Sustainable Development Goals.

UNDP's country-level presence and policy and programme expertise in public financial management is complemented by the OECD's technical expertise in international tax matters and access to networks of key players in the tax field. The joint initiative complements the broader efforts of the international community to strengthen co-operation on tax matters.

TIWB Objective

The objective of the TIWB Initiative is to enable sharing of tax audit knowledge and skills with tax administrations in developing countries through a targeted, real time "learning by doing" approach. Selected experts will work with local tax officials directly on current audits and audit-related issues concerning international tax matters and general audit practices relevant for specific cases. This is a specialized area of tax audit assistance, given its focus on providing assistance on real, current cases.

For each TIWB audit assistance programme, the goal will be to enhance capacity in the tax audit practice of the developing country tax administration (Host Administration). Through TIWB Programmes, the Host Administration benefits by improving the quality and consistency of its audits, which in turn brings greater certainty and potentially more revenues for the Host Administration. Over the longer term, the overall investment climate is likely to improve and a culture of taxpayer compliance can be built through more effective enforcement. More broadly, the state-society relationship can also be enhanced through greater engagement and confidence by taxpayers in the taxation process. This may lead ultimately to more effective and accountable governance. TIWB Programmes can complement existing tax-focused assistance programmes, to bring a practical approach to applying new knowledge.

Areas and forms of assistance

TIWB is focused on promoting hands-on assistance by sending Experts to build audit and audit-related skills pertaining to specific international tax matters and the development of general audit

skills within developing tax administrations. Experts will work together with tax auditors from the Host Administration on actual audit cases.

TIWB facilitates expert audit assistance in areas such as transfer pricing; thin capitalisation; advance pricing agreements; anti-avoidance rules; consumption taxes (e.g. VAT, GST); high net-worth individuals; pre-audit risk assessment and case selection; audit investigatory techniques; and industry-specific or sector-specific issues. TIWB does not cover assistance relating to customs matters nor is concerned with providing policy support, advice on legislative changes, issues related to (re)negotiations or other aspects of international tax treaties, or litigation, as existing organisations and programmes already offer support to developing country tax administrations on these matters.

The form and duration of audit assistance can vary, depending on the needs of the Host Administration as well as the types of tax matters involved, the availability of appropriate experts, and funding. For example, it may require eight weeks of assistance over three visits in the course of a six-month period.

Source: https://www.undp.org/content/undp/en/home/programmes-and-initiatives/tax-inspectors-without-borders.html and http://www.tiwb.org/about/

6.3 Capacity-building related to MAP

7. Technical assistance could also be provided to developing countries that have no or little MAP experience in the form of general training on the MAP process. That type of training, which does not require involvement in actual MAP cases between countries and does not, therefore, raise confidentiality concerns, could be provided at the national or regional level. This training should focus not only on the MAP process but also on the MAP-related commitments of the large number of countries that have joined the BEPS Inclusive Framework.[2] Active or retired tax officials of the competent authority units of countries that have substantial MAP experience should be involved in that type of capacity-building in order to make it as practical as possible.

8. The United Nations Secretariat and the OECD Secretariat have already started to provide capacity-building workshops on MAP. Recently, the UN, OECD and World Bank jointly delivered a MAP workshop for developing countries based on the contents of Chapter 4 (Mutual Agreement Procedure) of this Handbook. That workshop combined presentations on the different steps of the MAP process with a case study that allowed participants to gain hands-on experience of that process by working on a fictitious MAP case. That workshop is an example of collaboration between the partners of the Platform for Collaboration on Tax[3] which all support, in their different capacities, technical assistance, capacity building as well as knowledge creation and dissemination in developing countries.

2 See paragraphs 5 to 8 of Chapter 4 (Mutual Agreement Procedure).

3 The Platform for Collaboration on Tax which is a joint effort of the IMF, the OECD, the UN and the WBG, which was set up with a major aim "to better frame technical advice to developing countries as they seek both more capacity support and greater influence in designing international rules". See https://www.worldbank.org/en/programs/platform-for-tax-collaboration.

9. Training should also be available with respect to MAP arbitration for countries that wish to adopt that mechanism.

6.4 Framework agreements

> ***Note by the Secretariat***
>
> *Sections 6.4 and 6.5 were approved by the Committee at its eighteenth session as part of Chapter 5 (now renumbered Chapter 4) on MAP. The Subcommittee proposes to move these sections to this new Chapter 6 on possible improvements to MAP.*

10. The functioning of the MAP may be improved through the conclusion, under paragraph 3 of Article 25, of "framework agreements" between the competent authorities. Such framework agreements may address procedural or administrative issues related to the MAP (as is envisaged by the second sentence of paragraph 4 of the UN Model) or may deal with specific substantive treaty issues. For instance, where several MAP cases raising similar issues are pending, such framework agreements may allow for a quicker resolution of these cases by addressing the underlying substantive treaty issues. This approach was found to be particularly useful in the case of the India-United States tax treaty: within one year of its conclusion, a framework agreement signed in January 2015 facilitated the resolution of more than 100 cases in the information technology (software development and information technology enabled services) sector.[4]

11. The usefulness of such agreements will depend on the specific situation of the countries involved. They may be particularly helpful where there is a large number of pending MAP cases between two countries. They may also be helpful, however, in order to facilitate future discussions between countries that have not previously discussed MAP cases or that had difficulties in addressing a few cases. The agreements would then address administrative issues and procedural issues such as the conduct of regular meetings and the implementation of specific deadlines for the processing of the cases.

6.5 Use of technology

12. Since technology is ever evolving, the question arises of whether new technologies could be used to improve how competent authorities deal with the MAP and, in particular, how technology can complement and make more effective the way competent authorities interact during the MAP process. For developing and least developed countries, resource constraints still pose a great challenge in meeting the requirements for a successful implementation of the MAP. This section briefly describes some technologies that may be particularly relevant to the performance of competent authority functions, especially for procedural matters. New technology can facilitate the contacts and sharing of information between the taxpayers and competent authorities involved in a MAP case, facilitate documentation and filing requirements

4 Press release dated 16 January 2016 issued by India's Central Board of Direct Taxes, available at https://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/439/PressRelease_28-1-16.pdf

and help in setting up databases containing information relevant to the work of the competent authorities.

13. Technology now offers a range of tools that could be used to facilitate the contacts between the parties in a way which would make such exchanges more secure, structured and low cost by creating a common platform. The common platform may involve the use of secure clouds (i.e. shared platforms that are secure and with controlled access) or shared software (the same software programs deployed in multiple locations that are able to securely communicate with each other). Either would make it possible to deliver this sort of capability at much lower costs than in the past. When using these tools, a key consideration is the securing of information shared. Without a secure system, users would be hesitant or, even, prevented by laws or regulations in their jurisdiction from sharing sensitive information.

14. In the context of a MAP, information needs to be shared between the taxpayers and competent authorities and between the competent authorities themselves. In the case of tax treaties with respect to which MAP arbitration is allowed, information also needs to be exchanged between the competent authorities and the members of the arbitration panel (and their staffs, in some cases). This information must be kept confidential and can be extremely sensitive (e.g. the taxpayer's trade secrets). An access control system must be in place to provide adequate permissions to all of these parties.

15. A number of competent authorities in developed countries have already been using technical platforms for many years and the question arises whether these experiences can be shared and how new, innovative technologies may be used by developing countries.

16. One possible approach would be to set up a secure cloud server for the relevant dispute, to which the taxpayer and the competent authorities could upload the documents that they wish to share. The access to the documents would be restricted depending on the folder in which they are stored.

17. Technology might also help in setting feasible time schedules and deadlines as well as organizing the workflow of steps and approvals required by a MAP, thereby contributing to the timely resolutions of MAP cases. Such a scheduling tool could help the parties involved to schedule their meetings more efficiently by synchronizing with their other schedules, sending timely reminders of meetings etc.

18. Technology could provide simpler access to MAP for all taxpayers as well as providing them information concerning developments in their cases. The question of access to MAP does not only concern the availability of existing information, but also the submission of new information and even the filing of a MAP request. A common platform may help ensure that relevant data is structured and presented in a consistent way, facilitating its treatment. The documentation required to file a request for MAP could also be provided online, where it could easily be updated and accessed by the competent authorities. Ideally, the tool would include pre-programmed information concerning the type of documents necessary and a separate upload of each document type would be possible.

19. Similarly, where arbitration may be used to resolve issues that arise in a MAP case, technology could facilitate cost-effective cooperation between the competent authorities and/or the arbitrators as regards communications, meetings with arbitrators and transfer of documentation.

20. In addition, technology could help the competent authorities with time management concerning MAP cases prior to arbitration. The deadline within which the MAP has to be solved and the timeframes recommended for certain actions within that deadline may be automatically calculated and an additional electronic notification shall be sent as an "alert" to each of the officials assigned to a MAP case, letting them know that the deadline to complete a MAP prior to arbitration is approaching.

21. Technology could also help protect the privacy concerns of taxpayers in arbitration. Since arbitration involves third parties who may receive sensitive information belonging to the taxpayer in an arbitration process, technology could help provide a secure and protected environment under which such information is accessible to the arbitrators for limited use under the arbitration process.

22. Advanced technology could also aide the arbitration process. Modern technologies such as those involving artificial intelligence, blockchain etc. may also allow for procedural matters in an arbitration process to be done digitally. Further, the arbitration decision process may also be made digitally, particularly in baseball arbitration where the arbitrators have to choose one solution as opposed to another.

6.6 Non-binding dispute resolution (NBDR) mechanisms

6.6.1 Introduction

23. In recent years, tax administrations around the globe have become more active in challenging tax planning strategies of MNEs, which has led to an increase in disputes.[5] With implementation of country-by-country reporting in a wide range of countries, as well as mandatory sharing of rulings and the many other actions that are currently contemplated or about to be initiated pursuant to various international projects (BEPS and unilateral actions by specific countries), it is likely that the range and intensity of cross-border tax disputes will further increase.

24. Tax treaties offer the means of resolving these disputes through negotiation via the MAP process described in Chapter 4. While MAP is widely viewed as a useful tool, it is essentially non-existent in many countries and/or partly inefficient due to lack of capacity or domestic law support, inability of administrations to always reach mutual agreements, or otherwise.[6] If the MAP process is not successful or cannot be implemented, "unilateral" means of dispute resolution at the domestic level are the only means of addressing the dispute.[7]

5 See ¶ 1.5 and Appendix II.

6 See ¶ 1.5.

7 See Chapter 3.

However, trying to resolve a dispute at the domestic instead of at the inter-State level may not resolve double taxation, due to a lack of effective coordination between the taxing jurisdictions.

25. As explained in Chapter 5, following recent amendments to both the UN Model (in 2011) and the OECD Model (in 2017), countries, especially those with long experience with MAP, have undertaken to resolve "stalled" MAP cases by way of arbitration. Formally, these arbitration procedures are embedded into the MAP process as a "tie-breaker" and only take place in cases in which negotiations between Competent Authorities ("CA") have been unsuccessful for a two or three year period.

26. Some countries, including countries which question the appropriateness of arbitration for resolving tax disputes in their respective contexts, may wish to explore whether expert evaluation, mediation and other forms of Non-Binding Dispute Resolution ("NBDR") could become an alternative, or a precursory step, to arbitration.

27. All forms of NBDR discussed in this section have as a common feature full respect for the sovereignty of the parties to a MAP proceeding and do not involve any prior commitment to a binding resolution of the matter in controversy. In entering an agreement for NBDR, the parties may commit to use a NBDR tool in the MAP process and, if they agree on a resolution, to draft a CA agreement as would be the case in any mutually agreed MAP resolution.

28. The UN Model Treaty Commentary to Article 25 recognizes the potential benefits of consultation with outside experts:

> 41. 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 experience 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.

29. In 2017, the Commentary was expanded to recognize the potential benefits of NBDR:

> 41.1 The possibility for such assistance may include the utilization of non-binding methods of dispute resolution, such as mediation. For countries that wish to use such procedures, there are several non-binding methods that can be used to resolve disputes between parties at an early or later stage of the competent authority process. Such non-binding means of dispute resolution could range from facilitating the relational aspects of the competent authority process to providing insights or views on the substantive tax matters at hand in the dispute. Such methods are presently used for the resolution of tax disputes under the domestic laws of a number of countries. These procedures should, however, be utilized with due regard to issues such as the timing and duration of the

procedures, the mechanism and criteria for selection of the mediator or other such appointed person and, the treatment of confidential information.

30. The OECD Commentaries on Article 25 also recognize the possible use of such procedures within the MAP procedure.[8]

31. In broad terms, disputes can be resolved by agreement of the parties themselves or by submitting the dispute to an independent third person who decides the dispute for the parties. In either situation, the binding nature is derived from a sovereign decision of the parties. In the former situation, the parties must agree with the individual case outcome; whereas in the latter, the parties give their consent to accept the outcome before they actually know the content of the decision.

32. Dispute resolution by agreement can also occur with the help of a third person who facilitates agreement but does not decide the case for the parties. These forms of dispute resolution can be called "non-binding" because, in the absence of an agreement between the parties, the intervention of the third person does not entail a binding outcome.

33. In non-tax international treaties and commercial contracts alike, non-binding and binding forms of dispute resolution are frequently combined in a multi-tiered process. A widespread form of multi-tiered dispute resolution is to: (i) give the parties a certain timeframe for reaching agreement through negotiation; (ii) then obtain input of an expert and/or mediator; and (iii) finally, if these "non-binding" attempts are not successful within the fixed timeframe, the dispute can (or must) be escalated to binding dispute settlement (e.g. arbitration). The underlying objectives of such a multi-tiered process are that

a) The dispute should be resolved ideally by negotiation using the minimum third party intervention necessary;

b) Accordingly the formality, cost, and time commitment required from the parties and the level of third party intervention increases from tier to tier; and

c) The final tier provides for a final and binding decision (such as an arbitral decision).[9]

34. NBDR has been used by a number of tax administrations, with varying degrees of success, to facilitate the resolution of domestic tax disputes. The evolution of such techniques for use in the unique circumstance of treaty-based MAP could be useful. The purpose of this section is to provide guidance on forms of NBDR that could be adapted for resolving MAP cases.

35. It should be noted, however, that the experience of NBDR in the domestic tax context may not be easily transferred to the MAP context because the MAP process involves tax officials from two countries rather than a taxpayer and the tax administration of a country.

8 Paragraphs 86-87 of the Commentary on Article 25 of the OECD Model.

9 See section 6.6.9.

While NDBR is frequently used in the domestic tax context, there is no reported case where NBDR has been used to successfully resolve a MAP case.

36. While many forms of NBDR exist in the commercial world, this section focusses on elements of such procedures that could possibly be utilized in the specific MAP context – expert advice and mediation. For appropriate use in the CA process, such procedures need to be adapted to the specific needs of the parties. As so adapted, the procedures may differ in material respects from procedures used in commercial contexts.

37. Expert advice is a NBDR mechanism that consists of a technical expert reviewing evidence presented by the parties (or a party unilaterally). This procedure could involve an independent third party acting as an expert and rendering advice. In such a procedure, the inputs of the expert would be advisory in nature.

38. Mediation is a form of process-related assistance that involves the use of a mediator or facilitator to aid in providing a perspective on the discussions, identify issues that prevent resolution of a conflict, and bringing a problem-solving focus to the negotiating table.[10] The degree of activity of the mediator can range from a rather passive to a more active role, depending on the needs of the parties and the nature of the dispute. As with expert advice, inputs of a mediator would be advisory in nature.

39. Additional details of the procedures will be set forth below.

6.6.2 Potential advantages/disadvantages of NBDR processes in MAP

40. Potential advantages:

- Establish a process to develop expertise, and confidence in international tax dispute resolution under the UN Model in a manner consistent with each country's comfort level and allow the CAs to maintain control of the case resolution. Exploit the confidence generated in several countries at the domestic tax dispute level with respect to NBDR.
- May help clarify complicated issues between tax authorities and allow them to reach a MAP agreement, increasing the efficiency of the MAP process.
- Could be more efficient than a binding dispute resolution process as it may require fewer resources and lead to a higher satisfaction of the parties.
- Could provide incentive for the parties to reach mutual agreement on their own.
- Provide a means of "leveling the playing field" where the experience of CAs is unequal.

10 In commercial contexts, other forms of NBDR are often utilized – e.g., "conciliation" is a slightly more formal means of an, in essence, mediation process. As used in this chapter, "mediation" includes all elements of such procedures as are appropriate in the MAP process.

41. Potential disadvantages

- NBDR is not binding so there is no guarantee that the case will be resolved.
- If no agreement is found in the NBDR process, the dispute remains unresolved. In that latter sense, NBDR is less efficient and effective than binding dispute resolution.
- Investment of time and expense in developing such NBDR processes.

6.6.3 Expert advice

6.6.3.1 Description

42. Expert advice is a NBDR mechanism which consists of a technical expert reviewing evidence presented by the parties.[11] This procedure could involve an independent third party acting as an expert and rendering advice, in contrast to a judge or arbitrator appointed to decide a dispute. In such a procedure, the determination made by the expert would be advisory in nature with respect to the issue in question, as the parties determine to be appropriate. Expert advice is especially applicable with respect to disputes of valuation or those of a purely technical nature in commercial or business sectors.[12] It is also beneficial in cases involving special sectors of the economy or certain subjects such as financial services, hydrocarbons, environmental issues, water resources, or renewable energy sources.[13]

43. In the MAP context, expert advice could involve engagement, by one or both tax administrations, of a lawyer or other professional with experience in the technical, procedural, or other issues that the parties are unable to resolve. For example, expert advice could occur when a tax administration concludes that its position in a potential transfer pricing or other matter would benefit from review by an independent person. This could take place before or during a CA proceeding.

44. In short, an expert evaluation or determination process can be flexible, efficient, and timely where both parties are in agreement on the potential benefits of expert advice and agree upon the way forward.

6.6.3.2 Unilateral use of expert advice

45. In some situations, it may be appropriate for one or the other CA party to engage an expert on its own, perhaps for confirmation of certain factual matters. The engagement could be limited to factual or technical matters, or both (and would presumably not address procedural matters). The expert could be engaged to review documents only, or meetings could be scheduled. It could also result in an oral or written report, as may be appropriate to the

11 http://siteresources.worldbank.org/INTECA/Resources/15322_ADRG_Web.pdf

12 Ibid.

13 Expert advice could include a preliminary assessment of facts, evidence, or legal merits where parties agree on the nature and impact of an issue and the need for an independent evaluation. Such a process can be designed to facilitate the MAP process.

Country B tax authority. In such an informal process, the expert advice should be delivered in an efficient, timely manner. Costs would be those of the tax authority that engaged the expert.

46. From Country B's standpoint, such a process provides an external check on its internal determination. In such a unilateral consultation by Country B, there would need to be an engagement agreement with the expert, taking into consideration many of the issues identified for a CAA (for example, scope of work, time frame, and issues of confidentiality).

6.6.4 Mediation

6.6.4.1 Introduction

47. Mediation is a form of process-related assistance that involves the use of a mediator or facilitator to aid in providing a perspective on the discussions, identify issues that prevent resolution of a conflict, bringing a problem solving focus to the negotiating table, and facilitate mutual agreement between the parties, thereby avoiding further treaty procedures or ultimate litigation in either or both countries. It is not a procedure for one party to defeat the other; rather it is to decide the solution to their conflict (a win-win scenario).

48. The degree of activity of the mediator can range from a rather passive to a more active role, depending on the needs of the parties and the nature of the dispute. It can include:

- Monitoring the process or administrating the case.
- Guiding the discussions.
- Promoting a positive, consensual working relationship between the parties.
- Requesting information.
- Focusing the debate on key issues.
- Discussing (and potentially actively evaluating) with the parties the strengths and weaknesses of their respective arguments.
- Making process-related suggestions (e.g., commissioning of an expert; undertaking joint technical discussions in neutral facilities, agreeing on common / objective criteria, meeting with taxpayer, or otherwise).
- Offering input on total or partial solution of the dispute via compromise of respective positions.
- If the parties so wish, recommending concrete solutions to the dispute.

49. This mechanism is frequently used to resolve various types of disputes since it is a flexible process, conducted in confidentiality, in which a neutral person actively assists parties in working towards a negotiated agreement of a dispute or difference.[14] In many cases, the very existence of an independent third person helps the parties formulate their respective positions

14 See http://siteresources.worldbank.org/INTECA/Resources/15322_ADRG_Web.pdf.

more rationally and more objectively, thereby enhancing the chances of an agreement. Thus, the use of mediation can often make negotiations more efficient and help the parties avoid the waste of time and resources resulting from stalemate in negotiations. This increase of efficiency is often underestimated by disputing parties.

50. The effectiveness of tax mediation depends largely on the role played by the mediator in the process. While it may be thought that the most important thing to carry out this role effectively is a specific technique to reach the agreement between the parties, the field experience reveals that creating awareness in the parties about what mediation is and how it works is a key issue. For this purpose, the mediator´s role is fundamental.

51. By taking into account these premises, the parties may understand that compromising their respective positions opens a real possibility of achieving an agreement controlled by themselves.

52. Mediation could be adapted to the MAP process in specific situations. It could be especially useful between countries with different levels of experience. As discussed above, it is a reality of the current world of cross-border tax dispute that many countries, especially LDCs, have limited experience in MAP processes. Mediation and other forms of NBDR can be helpful in building confidence and experience in the handling of such disputes to protect the tax base of the respective countries.

53. The role of the mediator may offer an opportunity for the CAs to view a specific case, or the MAP process itself, from a different perspective. Such perspective could be acquired through the mediator's restatement of the positions or of the critical issues, which could highlight elements of the case or procedural context that are not possible to be recognized when seen from the perspective of a tax administration defending its taxing powers, adjustments, or the provision of relief from double taxation; or from the perspective of a MNE seeking to protect its own interests. Mediation may be the key in finding a solution for some of the more systemic issues of a MAP negotiation.

6.6.4.2 Role of the mediator

54. Special importance should be given to the role of the mediator who normally acts as a facilitator to aid parties to overcome their differences, providing guidance in identifying issues, engaging in joint problem-solving, and exploring creative settlement alternatives. Depending on the nature of the dispute, parties may require the mediator to go beyond this role and act as an evaluative mediator, providing factual and even legal evaluation of the case; yet, parties retain the full control of the decision to settle the dispute and specify the terms of resolution.[15]

15 http://www.cedr.com/CEDR_Solve/services/mediation.php.

6.6.4.3 Unanticipated problems

55. In any such mediation process, it should be anticipated that unforeseen issues will arise. Theses could evolve into technical problems that would complicate the MAP case.

56. In such a situation, the goal of a mediator would be to identify the key controversies and the issues surrounding them, seek a convergence of views of the two countries, and help the parties resolve critical misalignments that block resolution.

6.6.4.4 Choice of tested party in transfer pricing cases:

57. The choice of the tested party, which is typically the more limited scope party, can have a substantial effect on the profitability of each party. Differences between the posture of countries in CA proceedings often result from disparity on this issue.

58. In such a situation, the mediator's objective is not necessarily to force a choice or a solution regarding tested party, but to explore options and alternatives to align the two countries. Such steps may enable the mediator to bring the parties closer together in moving forward towards settlement.

6.6.4.5 Role of domestic experience

59. As indicated in Chapter 3, mediation is already used in some countries in the context of the resolution of domestic dispute resolution. For example, in the United Kingdom, the CA (HMRC) allows an advance dispute resolution ("ADR") process in which a specialist is brought into the proceedings to facilitate the negotiations.[16] The specialist is not necessarily an expert in taxation, but in ADR. The CA maintains responsibility for resolution (sovereignty) as negotiations proceed with the independent party. The proceedings may also be more efficient and, consequently, less costly. Further, the taxpayer's right to appeal is maintained. According to HMRC, the benefits of such ADR include:

- Impetus towards resolution via a fresh approach.
- Issues can be "unpacked" and alternatives explored on a confidential basis, with a potential lasting benefit beyond the discussions of the dispute itself.
- Even if the dispute is not resolved, respective positions can be sharpened possibly, prepared more effectively for litigation.

60. HMRC reports that most such ADR events have been concluded in one day and the average elapsed time from application to resolution was twenty-four weeks in large or complex cases and sixty-one days in small and medium-sized enterprise cases, which is a significant

16 See HM Revenue and Customs, Tax Disputes: Alternative Dispute Resolution (ADR) 2014, http://www.gov.uk/tax-disputes-alternative-dispute-resolution-adr.

contrast with the multi-day hearings and seventy-week average of the process of appeal for such cases.[17]

Note by the Secretariat

As regards paragraphs 59 and 60, the United Kingdom's observer has asked that the chapter not refer to the UK experience with domestic mediation since that experience did not seem relevant for MAP mediation. One other participant to the Subcommittee asked that the section be maintained.

The Committee is invited to decide whether section 6.6.4.5 should include a short description of a country's experience with mediation in the context of domestic dispute resolution even if the chapter deals with MAP mediation. If the answer is yes, which country should be referred to?

6.6.4.6 Role of an ombudsman

61. As explained in Chapter 3, the role of an ombudsman is typically focused in safeguarding taxpayers' rights at the domestic level, and its substantive participation in international tax disputes is non-existent.

62. However, its role from an international standpoint may still be crucial in MAP access issues. The ombudsman can act as a guardian body to ensure that the tax administration of its country properly applies and interprets the provisions of the Convention and thus, prevent the taxpayer from being denied access to the MAP in an unjustified manner. This issue, undoubtedly, could have an impact in the resolution of international tax disputes.[18]

6.6.5 Practical implementation and framework

63. Decades of experience with such NBDR processes in non-tax contexts counsels that a variety of practical elements will need to be addressed in designing and implementing such processes for use in disputes in the international tax treaty context. The following case study is used to provide context to address such elements:

BusCo Case Study

BusCo is a large multinational, integrated enterprise which designs/develops, manufactures, and distributes buses globally, headquartered in Country A with manufacturing and distribution operations throughout the world. In County B, wholly-owned subsidiary LocalCo has two assembly plants, producing different models, and a sales/distribution organization working through an independent dealer network.

The cross-border flow of goods and services historically included vehicles, management fees, and royalties for trademarks and technology under a licensing arrangement between BusCo and LocalCo with LocalCo characterized as an "at risk" entrepreneur paying royalties and services fees (excluding stewardship costs). BusCo

17 See Lloyd & Dennis, Tax Journal "Q&A: How Is ADR Working for Large Businesses?" (Feb. 5, 2015).

18 This specific role has been played by the Mexican Tax Ombudsman Agency (*PRODECON*, by its acronym in Spanish). Its complaint procedure has enabled this public body to meet and discuss with the Mexican tax authority when access to a MAP procedure, in accordance with the taxpayer's view, is being incorrectly denied.

sold buses at a fully-loaded cost plus 7%, which provided stable returns to its manufacturing function. LocalCo resold to independent customers based on local market conditions for specific models. LocalCo profitability varied over the years depending on demand for the two models it assembled and demand for the BusCo models. LocalCo developed its own warranty program hoping to stabilize and expand its sales base.

After a downturn in the global economy and mounting losses for both BusCo and LocalCo, the parent restructured its supply chain by closing one of the LocalCo assembly plants and converting LocalCo into a limited risk distributor and assembler of buses. The licensing agreement was terminated, the remaining assembly function of LocalCo was compensated on a Return on Value Added Costs ("ROVAC"), and the distribution function on a return on its sales, general and administrative (SG&A) costs (a so-called Berry Ratio method). In Years 1, 2, and 3 after the restructuring, LocalCo became profitable with thin margins sheltered by loss carryforwards (including plant closure costs).

Country B tax authorities challenged the restructuring with an assessment based on a determination that: (i) the licensing agreement and LocalCo's entrepreneur status were terminated early without compensation; (ii) LocalCo should have earned the profit that would have occurred if there had been no restructuring; and (iii) an alternative position asserting a capital gain on the disposition of the LocalCo business. In the absence of a successful MAP process, LocalCo and BusCo will incur double taxation,

Accordingly, BusCo and LocalCo sought MAP relief under the Country A – Country B Tax Convention on the basis that there was taxation not in accordance with the Convention. In discussions with the Country B tax authority, LocalCo was advised that the authority had limited experience in either MAP proceedings. Similarly, the Country A authorities advised BusCo to be patient with the process due to the lack of experience of Country B.

After three years in a MAP process, BusCo and LocalCo were frustrated with the lack of progress. Seeing no likelihood of successful resolution, the CAs agreed to undertake some type of NBDR process to facilitate a mutually acceptable resolution of the prior year assessment.

64. The inability to achieve closure of MAP cases in the situation of the BusCo Case Study is a reality faced by many countries and MNEs. The inquiry of BusCo and LocalCo about potential alternative processes is understandable. In the event that either, or both, of Country A and Country B are open to considering such procedures, there will be a variety of practical considerations to be addressed.

65. An illustration of the potential use of expert advice in the BusCo Case Study is presented below:

BusCo Case Study

As Country A and Country B discussed the potential of engaging in a NBDR process, it became apparent that the critical difference between their positions related to the

factual questions relating to the LocalCo market development activities which Country B believed constituted valuable intangibles for which LocalCo had borne the costs and developed the resultant expertise.

Country B proposed that an expert be engaged to provide an independent assessment of the factual elements underlying its position. Country A agreed and the parties worked out a schedule of timing so that the overall MAP process could proceed as efficiently as possible.

A mutually agreed upon expert was engaged. Within the agreed upon time period, the expert advised that the market development activities of LocalCo were generally within the range of normal functional elements of distributors of motor vehicles. On the other hand, the expert advised that LocalCo had developed a unique warranty process that had materially expanded the lifespan of the buses, whether purchased new or used, which had resulted in a continually increasing market share. The warranty process involved an annual customer payment for a lifetime warranty, with LocalCo having developed the service team to annually address issues of each vehicle. The expert advised that the warranty process had been independently developed by LocalCo taking advantage of elements of the local market.

With this factual input, the parties proceeded with their negotiation.

66. As noted in paragraph 45, in some situations, it may be appropriate for one or the other CA party to engage an expert on its own, perhaps for confirmation of certain factual matters. For example, in the BusCo Study, the Country B tax authority, which has little actual experience in MAP proceedings, could decide that it would benefit from an independent analysis elements of its position.

67. The following is an illustration of how mediation could be used in the BusCo Case Study:

BusCo Case Study

Armed with such input, Country B is confident that its assessment has a reasonable basis, though understanding that such issues are subject to material differences of opinion in specific situations (even among seasoned experts).

When Country A and Country B continued the MAP process, Country B presented the results of its expert advice process, which Country A found very interesting. Country A had resisted any suggestion that LocalCo may have developed a marketing intangible. Country B advised of its continuing belief that its position was a reasonable application of pertinent arm's length principles, though recognizing that there was a range of possible results for specific cases. Country B recognized that its assessment was at the high end of the range and it was prepared to negotiate to find a mutually acceptable result. In turn, Country A indicated interest in the Country B expert advice that there may be a factual basis for the Country B position. Accordingly, Country A advised that it would re-examine its position.

In continuing discussions, the parties made considerable progress but material differences remained. Country A suggested that they consider a binding arbitration process to provide an appropriate resolution. Country B was concerned about its lack of experience in binding dispute resolution, as compared to Country A. Accordingly, it proposed that they undertake a non-binding mediation process as a means of seeking agreement. Both countries recognized that a mutually acceptable resolution would, in all likelihood, be somewhere between their respective positions. Accordingly, they agreed to engage an independent mediator to address the issues.

As a result of the mediation process, an agreement was reached which was acceptable to Country A, Country B, and the taxpayers. Accordingly, the appropriate treaty processes were undertaken to implement the agreement, including correlative relief.

68. In a situation like the BusCo Case Study, the mediator may offer an opportunity for the CAs to view a specific case from a different perspective.

69. As noted in paragraph 55, unforeseen issues may arise during the mediation process. For example, in the BusCo Case Study, a disagreement on a factual issue concerning the local market warranty program developed by LocalCo could also evolve into a technical problem in the sense of whether the program could or should be characterized as a marketing intangible for transfer pricing purposes and the mediator could then identify the key controversies and the issues surrounding them to help the parties resolve the difference of views.

70. As indicated in paragraph 57, a disagreement on the choice of the tested party could also arise. The is illustrated as follows in the BusCo Case Study:

BusCo Case Study

The system or combined profits of the BusCo group, including those of LocalCo, will likely vary significantly from year to year. Prior to the change of methodology, LocalCo was an "entrepreneur" compensating BusCo via one-sided transfer pricing methodologies. As a result, residual profit or loss from the LocalCo operations resided in it and Country B. When the methodology was changed so that LocalCo was made a "limited risk manufacturer/distributor," the residual profit or loss was in BusCo.

As the mediator evaluated the positions of Country A and Country B, it was apparent that the critical issue was the conversion from one model and tested party (BusCo to LocalCo) was the critical issue.

71. In exploring options and alternatives to align the two countries, a mediator may suggest to consider further economic analysis or accounting for the impact of hard-to-value intangibles on profits. Another approach could be to evaluate the combined income data for the periods in question and use a two-sided transfer pricing method, profit split, for a high level view of the overall situation.

6.6.6 NBDR framework

72. An initial consideration for the implementation of NBDR will be whether the countries in question require a separate domestic legal framework to be able to have NBDR as possibility within a MAP. As noted in the Introduction, Article 25 in both the UN and OECD Model Treaties allow for NBDR as part of the MAP process. It is another question, however, whether the domestic law of a particular country might require a separate legal framework. This is a matter that needs to be evaluated on a country specific basis. In many countries, the legal basis for entering bilateral tax treaties provides sufficient authority for the CAs to adopt administrative guidelines, including with respect confidentiality, NBDR, and other matters.[19] In other countries, it may be that specific legislation could be necessary to enable the CA to agree to use of NBDR as an element of the MAP process.

73. A further consideration is whether countries should memorialize the terms of utilization of NBDR for MAP proceedings on a case-by-case specific basis or adopt a general framework for their relationship:

- A case-by-case basis would be facilitated by concluding a procedural CA agreement ("CAA") for individual cases.
- A general framework could apply to multiple cases, which could also be set out in a CAA.
    - A general framework offers the advantage of an economy of scale (in the sense of no need to renegotiate over and over again the same rules) and procedural efficiency. On the other hand, a disadvantage could be inflexibility, especially if the rules cannot be amended.
- It would also be possible to achieve a mixture by agreeing on a general framework with a set of default rules, allowing the countries to negotiate specific terms applicable to a specific case (such as for the specific areas of disagreement in the BusCo Case Study).

6.6.7 Issues to be addressed in a CAA

74. The issues that could be addressed in a CAA authorizing the parties to utilize NBDR as an element of their process, always retaining complete decision-making authority, could include the following:

- Nature of the procedure: expert advice or mediation, or the option to combine both (as discussed below).

19 Maintenance of sovereignty is, understandably, often a critical element of the dispute resolution process for many countries. It is unlikely that a country which has committed to MAP has a serious domestic law issue with NBDR since the contemplated processes are not binding. As a rule, if a tax authority has the capacity to enter into an agreement regarding a dispute, it also has authority to commit to a process whose outcome is not binding upon it without its consent. There is extensive practical and legal experience in non-tax areas in most countries that can be consulted for guidance on such issues.

- When should NBDR be initiated (since recourse to NBDR assumes that the competent authorities of two countries have reached the bilateral stage of the MAP and have already discussed and identified issues to be resolved, there would not be any need to wait for two years after the MAP request before initiating NBDR)?
- Is utilization of NBDR procedure optional or mandatory?
- Manner of determination of the issues to be discussed (e.g., through so-called "Terms of Reference" to be agreed at the outset of the NBDR procedure).
- Mandatory or optional stages of the procedure (e.g., determination of Terms of Reference, procedural discussions, written submissions, oral discussions, possibility of non-binding recommendations).
- Interaction with other procedures, notably domestic administrative or court proceedings and tax treaty arbitration (if available) -- e.g., is mediation a precursor to arbitration?
- Default timelines.
- Means of selection of the expert or mediator ("Neutral Third").
- Role, function and attributions of the Neutral Third.
- Interplay between more than one Neutral Third (e.g., mediator + expert).
- Eligibility, qualifications, conflicts of interest (and disclosure thereof), vetting, and appointment of Neutral Third.
- Impartiality obligations and rules on the safeguarding of independence of the Neutral Third.
- Confidentiality obligations of the Neutral Third and regime applicable to disclosed information (e.g., is the Neutral Third considered to be part of each CA for domestic law purposes? How can sensitive taxpayer information effectively be protected? To what extent would exchange-of-information rules apply)?
- Guidance on whether information submitted or proposals made during NBDR discussions may or may not be used in subsequent court proceedings or other contexts (so-called "without prejudice rules").[20]
- Initiation of the process – e.g., who, when, to whom, how?
    - Logistics of the process (place, language, translations, participants, transcripts and meeting minutes etc.).

20 This characteristic, at a domestic level, has provided confidence to parties to abandon part of their claims in the effort to find a solution to the conflict at hand. Thus, it is recommended that CAs, when designing a NBDR framework, provide that all of their proposals, offers, and positions will be safeguarded by the expert or mediator and will not be of public knowledge. By not setting any precedent, the CA know that the (possible) agreed solution will not be binding or repeatable in any other case and cannot be used in a future domestic court procedure.

- Possibility of allowing the Neutral Third to talk to one party in the hope of finding grounds for mutual agreement, without sharing the contents of the discussion and/or results with the other party (so-called "caucuses").
- Participation of the taxpayer (inclusion, exclusion, rights to be heard).
- Possibility of separate discussions between the CAs independent of the Neutral Third seeking to achieve mutual agreement.
- Termination of proceedings.[21]
- Possible form of cost allocation between the CAs or the taxpayers.

6.6.8 Combining several forms of NBDR in MAP

75. The procedural roles of experts and mediators are to a certain extent complementary (as reflected in section 6.6.7 above, with respect to issues to be addressed in a CAA for NBDR). Whereas the mediator relies on an ability to steer and frame the discussions between the parties and engage them in the exploration of potential solutions, the expert provides the parties with highly specialized technical expertise (in tax cases, one could for instance think of advice on comparable market prices at "arm's-length").

76. There are ways to combine the skill-sets of mediators and experts in order to enjoy the benefits of each of these procedures. Three possibilities are outlined below.

6.6.8.1 Agreement on methods and criteria

77. One way is for a mediator to help the parties find an agreement on methods and criteria, before the dispute is submitted to an expert. In fact, most successful mediations include a phase in which the parties discuss and agree on underlying principles, methods or criteria in order to resolve their dispute. In most disputes, there is more than one "objective" method and thus more than one "reasonable" perspective (as in the BusCo Case Study), which is often the root of disagreement. Acknowledging, reconciling, or combining the underlying rationales of the parties is crucial for reaching an agreement. Once the parties have agreed on a common methodology, an expert can carry out her operations more easily. In this way, mediation can effectively utilize expert evaluation (or expert determination).

6.6.8.2 Utilization of previous expert report

78. Another way is to conduct mediation on the basis of an existing expert report. In this scenario, the mediator would discuss the results of the expert investigations with the parties and, potentially, the expert. This can be particularly useful in cases in which the parties have a different interpretation of the expert report or in which one party contests the methodology of the expert. It should be noted that an early appointment of the mediator often helps to avoid

21 It is submitted that the suspension or termination of NBDR should always be possible if at least one CA, after serious consideration, comes to the conclusion that NBDR will not be effective. Flexibility should prevail over formalism, given in particular that CAs have already demonstrated their good will to find an amicable solution through the participation in a MAP.

such difficulties before they arise (as in the first possibility noted above). Once differences of view on the methodology applied by the expert have arisen, it may often be difficult to solve these through non-binding mechanisms of dispute resolution.

6.6.8.3 Parallel mediation and expert advice

79. A third way of combining these means of dispute resolution is to embed expertise into mediation, while the mediator and expert are working in parallel. The mediator would have a more procedural role and be responsible for moderating the overall discussions, whereas the expert (usually under the direction of the mediator) would inject valuable expertise and provide guidance for the discussions between the parties. The expert's work can be made useful either through a single written expert report or oral expert testimony, or on a continuing basis throughout the discussions. In certain circumstances, it may also be useful to allow the mediator to have separate discussions with the expert, if the mediator feels that he needs more information in order to better orientate the discussions.

80. Combining mediation and expert evaluation allows for much flexibility. Engaging both a mediator and an expert at the same time is certainly costlier than engaging either one of these.

6.6.9 NBDR as a precursor to arbitration

81. NBDR could be envisaged either as an alternative to arbitration[22] or as a supplementary means of dispute resolution, preceding arbitration.

82. Providing for binding dispute resolution as a measure of last resort would further the effectiveness of the tax treaty provisions because it gives CAs an additional incentive to apply the tax treaty consistently. At the same time, a multi-tiered approach including NBDR would ensure that cases are, as a rule, solved by mutual agreement rather than by the decision of arbitrators.

83. Further, NBDR as a precursory step to arbitration can increase the efficiency of an arbitration, notably because the debate can more easily be focused on the key issues ("terms of reference"). If, during the NBDR phase, an independent expert has carried out specific fact-finding tasks or economic evaluations, the parties may agree that the expert report is used during an ensuing arbitration.

84. In multi-tiered procedures it is, however, crucial that the sequence of stages does not delay the proceedings overall. This should be ensured by providing for strict (default) timelines, which the CAs can only extend jointly and not indefinitely. NBDR should be completed at the point in time when referral to arbitration would otherwise become mandatory, so that it does not extend the maximum duration of the proceedings by delaying the initiation of arbitration.

22 See Chapter 5.