





## Introduction

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

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

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

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

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

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

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

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

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

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

8. As explained in sections I and II below, both the European Union and the OECD have recently made significant progress in improving the process for solving tax convention disputes between countries. Given the importance of improving trade and investment flows between developing and developed countries, it seems entirely

a(n)-34.526(t)-d1-41.9318(l)-257084(7(a)-41.928(c))-29.4113  
e -34.526(7 )-235.931





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

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

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

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

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

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

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

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

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

25. An attempt could also be made to design an arbitration mechanism adapted to the relations between developed and developing countries. If costs and resources are indeed a major obstacle for developing countries, one could explore a simplified "last-best-offer" type of arbitration where a single