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Mutual agreement procedure
— dispute avoidance and resolution

ANNEX II

CHANGES TO THE UN MODEL DERIVING FROM THE REPORT ON BEPCH~ÉÞ GA*Á Ú RÔn Þ $l9 c „lD @ , &b&Á from that analysis and which the Subcommittee agreed to recommend to the Co number of changes that could either be made to the Commentary on the UN UN Guide to the Mutual Agreement Procedure, depending on where the changes should be made.

practice 10 (p. 101 of Annex 5)	found in the Commentary on Article 2 should be amended to reflect the change made to that paragraph in the OECD Model. The quotation of p

C. Changes related to MAP adjustments and domestic time limits

dealing with the length of time during which State B is to be under obligation to make an appropriate adjustment […]. [One possible approach is to address this issue through a provision limiting the length of time during which a primary adjustment may be made

security charges, or any other charges paid where there is a direct connection between the levy and the individual benefits to be received". The OECD Commentary further observes:

> 4. Clearly a State possessing the right to tax an item of income or capital under the Convention ~~taxing powers — and it alone —~~ may levy the taxes imposed by its legislation together with any duties or charges accessory to them: increases, costs, interest, penalties etc. It has not been considered necessary to specify this in the Article, as it is obvious that ~~in the levying of the tax~~ a Contracting State that has the right to levy a tax may also levy the accessory duties or charges related to ~~depend on the same rule as~~ the principal duty. Most States, however, do not consider that interest and penalties accessory to taxes covered by Article 2 are themselves included within the scope of Article 2 and, accordingly, would generally not treat such interest and penalties as payments to which all the provisions concerning the rights to tax of the State of source (or situs) or of the State of residence are applicable, including the limitations of the taxation by the State of source and the obligation for the State of residence to eliminate double taxation. Nevertheless, where taxation is withdrawn or reduced in accordance with a mutual agreement under Article 25, interest and administrative penalties accessory to such taxation should be withdrawn or reduced to the extent that they are directly connected to the taxation (i.e. a tax liability) that is relieved under the mutual agreement. This would be the case, for example, where the additional charge is computed with reference to the amount of the underlying tax liability and the competent authorities agree that all or part of the underlying taxation is not in accordance with the provisions of the Convention. This would also be the case, for example, where administrative penalties are imposed by reason of a transfer pricing adjustment and that adjustment is withdrawn because it is considered not in accordance with paragraph 1 of Article 9.
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> 5. The Article does not mention "ordinary taxes" or … [the rest of the paragraph is not reproduced here]

Replace the quotation of paragraph 49 of the OECD Model that is currently found in paragraph 9 of

PART 2 - CHANGES THAT COULD EITHER BE MADE TO THE COMMENTARY ON THE UN MODEL OR INCORPORATED INTO THE UN GUIDE TO THE MUTUAL AGREEMENT PROCEDURE

E. Changes related to the legal status of a mutual agreement

14. Paragraph 45 of the Report on Action 14 indicated that "[i]t is intended to make amendments to the Commentary on Articles 3 and 25 of the OECD Model Tax Convention as part of the next update of the OECD Model Tax Convention in order to clarify the legal status of a mutual agreement entered into under Article 25(3)."

15. The Subcommittee considers that the new paragraphs 6.1 to 6.3 that will be added to the OECD Commentary for that purpose reflects a valid legal interpre.1.6 (r)-2 (e)11.2.ia.ttr (o)12.9 (se)032p2(2 Td 35 4.890.04

the Law of Treaties, allow domestic courts to take account of such an agreement. The object of Article 25 is to promote, through consultation and mutual agreement between the competent authorities, the consistent treatment of individual cases and the same interpretation and/or application of the provisions of the Convention in both States. Article 25 also authorises the competent authorities to resolve, by mutual agreement, difficulties or doubts as to the interpretation or application of the Convention; such a mutual agreement, reached pursuant to the express mandate contained in paragraph 3 of the Article,

Option 1 - Keep the UN Commentary as it currently reads:

Keep the following paragraphs 47-48 of the OECD Model as currently quoted in paragraph 9 of the Commentary on Article 25 of the UN Model, but in order to clarify that the paragraphs currently quoted do not include the relevant amendments that will be made to the OECD Commentary, add a footnote to each paragraph as follows:

> 47.[1] Article 25 gives no absolutely clear answer as to whether a taxpayer initiated mutual agreement procedure may be denied on the basis that there has not been the necessary payment of all or part of the tax in dispute. However, whatever view is taken on this point, in the implementation of the Article it should be recognised that the mutual agreement procedure supports the substantive provisions of the Convention and that the text of Article 25 should therefore be understood in its context and in the light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance. States therefore should as far as possible take into account the cash flow and possible double taxation issues in requiring advance payment of an amount that the taxpayer contends was at least in part levied contrary to the terms of the relevant Convention. As a minimum, payment of outstanding tax should not be a requirement to initiate the mutual agreement procedure if it is not a requirement before initiating domestic law review. It also appears, as a minimum, that if the mutual agreement procedure is initiated prior to the taxpayer's being charged to tax (such as by an assessment), a payment should only be required once that charge to tax has occurred.
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> 48.[2] There are several reasons why suspension of the collection of tax pending resolution of a mutual agreement procedure can be a desirable policy, although many States may require legislative changes for the purpose of its implementation. Any requirement to pay a tax assessment specifically as a condition of obtaining access to the mutual agreement procedure in order to get relief from that very tax would generally be inconsistent with the policy of making the mutual agreement procedure broadly available to resolve such disputes. Even if a mutual agreement procedure ultimately eliminates any double taxation or other taxation not in accordance with the Convention, the requirement to pay tax prior to the conclusion of the mutual agreement procedure may permanently cost the taxpayer the time value of the money represented by the amount inappropriately imposed for the period prior to the mutual agreement procedure resolution, at least in the fairly common case where the respective interest policies of the relevant Contracting States do not fully compensate the taxpayer for that cost. Thus, this means that in such cases the mutual agreement procedure would not achieve the goal of fully eliminating, as an economic matter, the burden of the double taxation or other taxation not in accordance with the Convention. Moreover, even if that economic

burden is ultimately removed, a requirement on the taxpayer to pay taxes on the same income to two Contracting States can impose cash flow burdens that are inconsistent with the Convention's goals of eliminating barriers to cross border trade and investment. Finally, another unfortunate complication may be delays in the resolution of cases if a country is less willing to enter into good faith mutual agreement procedure discussions when a probable result could be the refunding of taxes already collected. Where States take the view that payment of outstanding tax is a precondition to the taxpayer initiated mutual agreement procedure, this should be notified to the treaty partner during negotiations on the terms of a Convention. Where both States party to a Convention take this view, there is a common understanding, but also the particula

Convention. [the following three sentences are currently in paragraph 48 of the Commentary on Article 25] Even if a mutual agreement procedure ultimately eliminates any double taxation or other taxation not in accordance with the Convention, the requirement to pay tax prior to the conclusion of the mutual agreement procedure may permanently cost the taxpayer the time value of the money represented by the amount inappropriately imposed for the period prior to the mutual agreement procedure resolution, at least in the many common case where the respective interest policies of the relevant Contracting States do not fully compensate the taxpayer for that cost. Thus, this means that in such cases the mutual agreement procedure would not achieve the goal of fully eliminating, as an economic matter, the burden of the double taxation or other taxation not in accordance with the Convention. Moreover, even if that economic burden is ultimately removed, a requirement that the taxpayer pay taxes on the same income to two Contracting States can impose cash flow burdens that are inconsistent with the Convention's goals of eliminating barriers to cross border trade and investment. As a minimum, payment of outstanding tax should not be a requirement to initiate the mutual agreement procedure if it is not a requirement before initiating domestic law review. States may wish to provide so expressly in the Convention by adding the following text to the end of paragraph 29

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procedure discussions when a probable result could be the refunding of taxes already collected. [the rest of the paragraph has been moved to new paragraph 1.43.1] In many States, the suspension of the assessment and/or collection of tax pend

period that the mutual administrative assistance is pending. This option aims to incorporate the

and charges over the period in which the payment of taxes was suspended, should the competent authority of one or both Contracting States find the request for mutual agreement procedure to be unjustified, or based on false pretences. ~~States may wish to provide so expressly in the Convention by adding the following text to the end of paragraph 2:~~

~~The suspension of assessment and collection procedures during the period that any~~ mutual ~~agreement proceeding is pending shall be available under the same conditions as apply~~ to a ~~person pursuing a domestic administrative or judicial remedy~~.

It also appears, as a minimum, that if the mutual agreement procedure is initiated prior to the

22. The Committee is therefore invited to adopt one of the following two options:

Option 1 - Changes to the Commentary on the UN Model:

Amend paragraph 9 of the Commentary on Article 25 of the UN Model by adding the following new quoted paragraphs 37.1 to 37.6 immediately after quoted paragraph 37:

> 37.1 The combination of bilateral tax conventions concluded among several States may allow the competent authorities of these States to resolve multilateral cases by mutual agreement under paragraphs 1 and 2 of Article 25 of these conventions. A multilateral mutual agreement may be achieved either through the negotiation of a single agreement between all the competent authorities of the States concerned or through the negotiation of separate, but consistent, bilateral mutual agreements.
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> 37.2 This may, for instance, be the case to determine an appropriate allocation of profits between the permanent establishments that an enterprise has in two different States with which the State of residence of the enterprise has tax conventions. In such case an adjustment made with respect to dealings between the two permanent establishments may affect the taxation of the enterprise in its State of residence. Based on paragraphs 1 and 2 of Article 25 of the tax conventions between the State of residence of the enterprise and the States in which the permanent establishments are situated, the competent authority of the State of residence of the enterprise clearly has the authority to endeavour to resolve the case by mutual agreement with the competent authorities of the States in which the permanent establishments are situated and to determine the appropriate attribution of profits to the permanent establishments of its resident in accordance with both tax conventions. Where the tax conventions between the State of residence of the enterprise and the States in which the permanent establishments are situated contain different ver (a)2 (i)-2.6 (n)43r (t)-2.7 (v)11.

the permanent establishments are situated enables those two States to consult together to ensure that the convention operates effectively and that double taxation that can occur in such a situation is appropriately eliminated.

37.5 The desire for certainty may result in taxpayers seeking multilateral advance pricing

where the resolution of the case may affect or be affected by taxation in third States.

Amend paragraph 9 of the Commentary on Article 25 of the UN Model by replacing quoted paragraph 55 by the following new paragraphs 55 to 55.2:

> 55. The second sentence of paragraph 3 enables the competent authorities to deal also with such cases of double taxation as do not come within the scope of the provisions of the Convention. Of special interest in this connection is the case of a resident of a third State having permanent establishments in both Contracting States. [rest of existing paragraph 55 is moved to new paragraph 55.1] The second sentence of paragraph 3 allows the competent authorities of the Contracting States to consult with each other in order to eliminate double taxation that may occur with respect to dealings between the permanent establishments. This could for instance be the case where one or both of the Contracting States have no bilateral tax convention with the third State. Where both Contracting States have a convention with the third State, the combination of these two conventions may, however, allow the competent authorities of all three States to resolve the case by mutual agreement under paragraphs 1, 2 and 3 of Article 25 of

profits of such permanent establishments, however, only to the extent allowed by their

I. Changes related to the need to ensure that both competent authorities are made aware of MAP requests being submitted

25. Minimum standard 3.1 of the Report on Action 14 provided that in order to ensure that both competent authorities are made aware of MAP requests being submitted and are able to give their views on whether the request is accepted or rejected, countries should either amend paragraph 1 of Article 25 to permit a request for MAP assistance to be made to the competent authority of either Contracting State or implement a bilateral notification or consultation process for cases in which the competent authority to which the MAP case was presented does not consider the taxpayer's objection to be justified.

26. The Subcommittee examined the new paragraph 31.1 (reproduced below) that will be added to the OECD Model in order to clarify the meaning of the phrase "appears to be justified" in paragraph 2 of Article 25. ~~While it generally agreed with the view expressed in that paragraph, i~~It concluded that it seemed more appropriate to include that view in the UN Guide to the Mutual Agreement Procedure together with a sentence that would indicate that it is a good practice for the competent authority of a Contracting State that receives a request under paragraph 1 of Article 25 but that considers that the objection reflected in that request is not justified to notify the competent authority of the other State accordingly. The Subcommittee therefore invites the Committee to recommend that when the UN Guide to the Mutual Agreement Procedure is revised, it should [reflect] [discuss] what is included in the following paragraph of the OECD Commentary together with the additional sentence that appears between brackets:

> 31.1 The determination whether the objection "appears … to be justified" requires the competent authority to which the case was presented to make a preliminary assessment of the taxpayer's objection in order to determine whether the taxation in both Contracting States is consistent with the terms of the Convention. It is appropriate to consider that the objection is justified where there is, or it is reasonable to believe that there will be, in either of the Contracting States, taxation not in accordance with the Convention. [Where that is not the case and the competent authority to which the case was presented concludes that the objection is not justified, it should notify the competent authority of the other Contracting State of its conclusion in order to ensure that both competent authorities are made aware of MAP requests that have been submitted in relation to the convention between the two States.]

27. As regards the change proposed to paragraph 1 of Article 25 of the OECD Model in order to allow a MAP request to be presented to either competent authority, however, the Subcommittee did not consider that a similar change should be made to the UN Model. For that reason, it did not consider that the consequential changes made to the Commentary of the OECD Model should be quoted in the UN Model. In order to clarify that the paragraphs currently quoted in paragraph 9 of the Commentary on Article 25 of the UN Model do not include

taxation notwithstanding a court decision that such taxation was in accordance with the provisions of a tax treaty. In such a case, nothing (e.g. administrative policy or practice) should prevent the competent authorities from reaching a mutual agreement pursuant to which a Contracting State will relieve taxation considered by the competent authorities as not in accordance with the provisions of the tax treaty, and thus depart from a decision rendered by a court of that State.

30. Since paragraph 9 of the Commentary on Article 25 of the UN Model currently includes the existing version of paragraphs 35 and 42 (with adaptations) of the Commentary on Article 25 of the OECD Model, the Subcommittee also recommends that, in order to clarify that the paragraphs currently quoted do not include the amendments that will be made to the OECD Commentary, the following footnote be added to these quoted paragraphs:

Add the following footnote at the end of paragraphs 35 and 42 of the OECD Model which are quoted in paragraph 9 of the Commentary on Article 25 of the UN Model:

[Footnote] This paragraph corresponds to paragraph [35 or 42, as the case may be] of the OECD Model as it

principle. However, economic double taxation may occur, for example, if such a taxpayer initiated adjustment increases the profits of an enterprise of one Contracting State but there is no appropriate corresponding adjustment to the profits of the associated enterprise in the other Contracting State. The elimination of such double taxation is within the scope of paragraph 2. Indeed, to the extent that taxes have been levied on the increased profits in the first-mentioned State, that State may be considered to have included in the profits of an enterprise of that State, and to have taxed, profits on which an enterprise of the other State has been charged to tax. In these circumstances, Article 25 enables the competent authorities of the Contracting States to consult together to eliminate the double taxation; the competent authorities may accordingly, if necessary, use the mutual agreement procedure to determine whether the initial adjustment met the conditions of paragraph 1 and, if that is the case, to determine the amount of the appropriate

application, having as their direct and necessary consequence the charging of tax against the complainant contrary to the provisions of the Convention. Thus, for example, if a change to a Contracting State's tax law would result in a person deriving a particular type of income being subjected to taxation not in accordance with the Convention, that person could set the mutual agreement procedure in motion as soon as the law has been amended and that person has derived the relevant income or it becomes probable that the person will derive that income. Other examples include filing a return in a self assessment system or the active examination of a specific taxpayer reporting position in the course of an audit, to the extent that either event creates the probability of taxation not in accordance with the Convention (e.g. where the self assessment reporting position the taxpayer is required to take under a Contracting State's domestic law would, if proposed by that State as an assessment in a non-self assessment regime, give rise to the probability of taxation not in accordance with the Convention, or where circumstances such as a Contracting State's published positions or its audit practice create a significant likelihood that the active examination of a specific reporting position such as the taxpayer's will lead to proposed assessments that would give rise to the probability of taxation not in accordance with the Convention). Another example might be a case where a Contracting State's transfer pricing law requires a taxpayer to report taxable income in an amount greater than would result from the actual prices used by the taxpayer in its transactions with a related party, in order to comply with the arm's length principle, and where there is substantial doubt whether the taxpayer's related party will be able to obtain a corresponding adjustment in the other Contracting State in the absence of a mutual agreement procedure. Such actions may also be understood to include the bona fide taxpayer initiated adjustments which are authorised under the domestic laws of some countries and which permit a taxpa 0.002 Tc o8b5 (t)-4.6 (r)8(

FOR THE UN MODEL OR FOR THE UN GUIDE TO THE MUTUAL AGREEMENT PROCEDURE

L. Changes related to the footnote to Art. 25(5) of the OECD Model

34. Paragraph 23 of the Report on Action 14 indicated that:

> In order to provide transparency with respect to country positions on MAP arbitration, the footnote to paragraph 5 of Article 25 will be deleted and paragraph 65 of the Commentary on Article 25 will be appropriately amended when the OECD Model Tax Convention is next updated. Consequential changes to the Commentary on Article 25 would also be made at the same time as these amendments. These changes to the Commentary on Article 25 will include in particular suitable alternative provisions for those countries that prefer to limit the scope of MAP arbitration to an appropriately defined subset of MAP cases.

35. The Subcommittee concluded that since Alternatives A and B of Article 25 of the UN Model recognize that MAP arbitration provisions are purely optional, the footnote to Article 25 of the OECD Model and the related Commentary were not relevant for the UN Model.