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CHAPTER 11: DISPUTE AVOIDANCE AND RESOLUTION

1. Introduction to Dispute Avoidance and Resolution in Domestic and Cross-Border Contexts

1.1 Importance

1. Dispute avoidance and resolution mechanisms are essential to the effective and efficient functioning of all tax administrations. If properly designed and implemented, dispute avoidance and resolution mechanisms make it possible to resolve differences between tax administrations and taxpayers regarding the interpretation and application of the laws in a fair and expedited manner. They reduce the uncertainty, expense, and delay associated with a general resort to litigation or a failure to provide any recourse. They also can avoid the integrity issues sometimes associated with an over-reliance on *ad hoc* (case-by-case) settlements.

2. For the same reasons, dispute avoidance and resolution mechanisms are also of critical importance to taxpayers. This is particularly the case in countries that do not yet have strong and independent judicial systems with adequate tax expertise. Access to effective dispute avoidance and resolution mechanisms that are applied equitably to foreign investors typically is a key consideration when such investors are evaluating a potential new investment or expansion of an existing investment.

1.2 Goals of dispute avoidance and resolution mechanisms

3. The goal of dispute avoidance and resolution mechanisms is to facilitate the efficient and equitable collection of tax revenues properly due.

4. This should minimize controversy, cost, uncertainty, and delay for both tax administrations and taxpayers.

5. The most efficient method of addressing disputes is to prevent them from arising. Tax administrations seeking to use their resources most efficiently would be well-advised to focus in the first instance on mechanisms for avoiding disputes, while ensuring that appropriate dispute resolution mechanisms are available if necessary.

1.3 Differences between domestic and cross-border disputes

6. In the cross-border context, dispute avoidance and resolution mechanisms are particularly important to avoid double taxation of the same income to a taxpayer or to associated enterprises. They also avoid the imposition of tax not in accordance with the provisions of the applicable tax treaty, if any.

7. In the cross-border context, it is necessary for both tax administrations involved in a dispute to give effect to the provisions of any applicable tax treaty and to provide rules and procedures for departing from the domestic law result where necessary to resolve disputes.

2. Special Considerations for Developing Countries

2.1 Resource limitations

8. Although even large developed country tax administrations often face resource limitations, such limitations are likely to be much greater in the typical developing country administration. Such limitations may affect staffing levels, training budgets, access to commercial databases and other research materials, access to outside experts, travel funding, and other factors.

9. It should be recognized that such resource limitations may put such tax administrations at a real or perceived disadvantage when dealing with larger, better-resourced administrations. Therefore, it is particularly important for developing countries that dispute avoidance and resolution mechanisms be designed to operate as efficiently as possible, to minimize the demand on tax administration resources.

10. Efficient dispute avoidance and resolution mechanisms should benefit taxpayers as well. This is important particularly for multinational enterprises as they are called on to comply with the tax laws and reporting requirements of many dozens of countries and to address any audits or disputes that may arise.

2.2 Limited experience so far

11. Most developing country tax administrations have focused on transfer pricing issues more recently than many of the larger developed country administrations. However, countries such as India have now been developing and applying transfer pricing principles for a decade, and China, India, and other countries have quickly acquired substantial expertise. Therefore, bridging the experience gap may be only a matter of time in some cases.

12. The experience over time of those countries may be of particular assistance to other developing countries. However smaller developing country tax administrations may face more significant challenges that will require increased training and other capacity building. This is another important reason to design dispute avoidance and resolution mechanisms that operate as efficiently as possible.

3. Dispute Avoidance Mechanisms – Domestic

3.1 Legislation and Other Guidance

3.1.1 Benefits of transfer pricing legislation and other guidance

13. As in other areas of the law, it is important to publish clear guidance in advance regarding any legal requirements that will be applied with respect to transfer pricing. This is equally important for tax administrations, which need such guidance to apply the law properly and equitably, and for taxpayers, which must comply with

the law. Clear guidance can help avoid unexpected results, which pose significant concerns for both tax administrations and taxpayers, and thereby minimize controversy and reassure potential investors.

14. Guidance can serve these purposes only if it is clear and detailed enough to be clearly understood by both tax administrations and taxpayers. Countries that have adopted transfer pricing legislation have struck various balances between the provision of general principles and detailed rules in that legislation and accompanying guidance. Where general principles are preferred, it is often advisable, for the sake of clarity, to supplement them with examples illustrating their application.

15. Developing countries seeking to adopt transfer pricing legislation or revise existing legislation generally base such legislation on the arm's length principle, which is adopted in both the UN and OECD model conventions and in most national legislation throughout the world. As long as this remains the case, departures from the arm's length principle will create an increased risk of double or unexpected taxation, with no realistic prospect of cross-border relief. This could make the costs of doing business in the country concerned prohibitive and have the effect of discouraging cross-border trade and investment, with negative effects on sustainable development. While it is for each country to determine its own tax system, the desire to avoid double taxation has been an important factor in the very broad acceptance of the arm's length principle internationally.

16. Developing countries whose tax systems are at an early stage of development or face severe resource constraints may choose, for practical reasons, to adopt an approach to transfer pricing that is simplified in comparison to that adopted by more developed countries and recommended by the Transfer Pricing Guidelines. Where a simplified approach is adopted, care should be taken, for the reasons noted above, to avoid results that depart from the arm's length principle. Where it is decided to adopt a simplified approach, it may be advisable to reevaluate that decision periodically, as the simplified approach may not continue to meet the needs of the tax administration as it addresses more complex transactions, or may no longer be needed for practical reasons.

3.1.2 Situations in which transfer pricing legislation may not be needed

17. The setting of legislative priorities obviously is a matter for each country to decide for itself, in view of its particular circumstances and policies.

18. Transfer pricing legislation may not be seen as a first priority by developing countries whose tax systems are still in a relatively early phase of legal development, especially if cross-border trade and investment are not yet significant in volume.

19. Many multinational enterprises apply transfer pricing policies to price their intercompany transactions on a consistent basis globally, so the absence of national legislation in a particular country may not pose a significant issue.

20. However, where a country that has not adopted specific transfer pricing legislation decides that it is appropriate to challenge a company's intercompany pricing, it may find that it lacks a clear legal basis for such a challenge. While some countries may have general legal provisions or principles, such as general anti-avoidance rules or substance-over-form doctrines, they may find it difficult to successfully challenge intercompany pricing on this basis.

21. Such an approach may also raise issues of fairness to the taxpayer, if the application of general principles to intercompany pricing is not sufficiently clear and predictable. If the result is not seen as fair and predictable, this may create significant controversy. Therefore, potential investors may view the absence of transfer pricing guidance as a negative factor.

22. Because of the above considerations, it is normally advisable for developing countries to adopt transfer pricing guidance as soon as they are in a position to do so.

3.2 Advance Rulings

23. Advance rulings regarding the application of a country's laws to a taxpayer's particular facts (structured as unilateral APAs in some countries) can often be helpful in avoiding disputes between that taxpayer and the tax administration.

24. Where applicable guidance is not sufficiently detailed, the availability of advance rulings may have particular importance to taxpayers.

25. When considering new issues, tax administrations may prefer, as an initial matter, to provide guidance by ruling so that they have an opportunity to consider the issues more fully before committing themselves to a general approach.

26. On the other hand, where the issue is one of general application, it may be less efficient for the tax administration to provide case-specific rulings than to issue general guidance.

27. A heavy reliance on *ad hoc* rulings may also give rise to integrity concerns and associated equity issues unless there is a robust review process in place.

28. Where guidance is routinely proved by rulings, it may prove difficult to strike an appropriate balance between legitimate taxpayer confidentiality concerns and the level of transparency that may be desired. While it generally is a best practice to maximize transparency, it normally would be inappropriate for the tax administration to publish case-specific rulings in their entirety, as this would risk divulging sensitive taxpayer information to competitors. While many countries have a policy of publishing rulings after removing sensitive taxpayer information, even this approach may effectively disclose the identity of the taxpayer in smaller markets, with negative consequences for the taxpayer's competitive position. It may, therefore, make sense for tax administrations to use case-specific rulings primarily to provide guidance on

issues that are unique, novel, or particularly difficult, or as an interim measure as adequate published guidance is being developed.

29. One alternative means of promoting transparency and consistent treatment of taxpayers, currently used by Nigeria, is to publish generally applicable guidance on issues of broad application after analyzing them in an enhanced relationship process with a particular taxpayer.

3.3 Role of Tax Audit Practices and Policies

30. Tax audit practices and policies play a key role in any effort by a tax administration to avoid or minimize disputes with taxpayers.

31. To the extent that a tax administration's audit practices and policies are seen as fair and are implemented equitably, it becomes less likely that taxpayers will see a need to pursue dispute resolution options.

32. Conversely, where a tax administration has systemic integrity issues or applies the law in a manner that is not seen as fair and equitable or is unpredictable, taxpayers are more likely to see a need to seek resolution of the dispute elsewhere.

33. All tax administrations seeking to avoid or minimize disputes with taxpayers would, therefore, be well-advised to devote significant attention to the operation of their tax audit practices and policies. Issues relating to tax audits are discussed in more detail in Chapter __ of this manual.

34. Tax administrations may also find useful the practical guides and information publications issued by the Forum on Tax Administration (FTA) as part of its Tax Administration Guidance & Information Series.[1]

35. In addition, tax administrations may wish to consider whether they should move towards an "enhanced relationship" between tax authorities, taxpayers and their advisors, which is designed to increase the level of transparency and certainty for both tax authorities and taxpayers. This type of initiative must be carefully implemented to ensure the consistent application of legal provisions, protect taxpayer rights, and avoid integrity issues, while not devoting excessive resources to the more compliant end of the taxpayer spectrum. However, it is widely seen as having been successfully implemented in some developed countries already, notably the Netherlands and the United Kingdom, and others, such as Nigeria, currently are testing this approach on some matters.

[1] See http://www.oecd.org/dataoecd/39/38/48155143.pdf. The FTA publications cover both direct and indirect tax issues, for enterprises of all sizes and high net worth individuals, and include practical information, recommendations, and guides for tax administration staff regarding the structuring and operation of tax administrations, the management of compliance risk, and other issues of common interest to tax administrations.

4. Dispute Avoidance Mechanisms – Cross-Border

4.1 Tax Treaty Provisions

4.1.1 Division of taxing jurisdiction

36. Tax treaties significantly reduce the scope for cross-border disputes. Without a tax treaty, income from cross-border transactions or investment is subject to potential double taxation whenever the laws of the source and residence countries differ. Tax treaties seek to eliminate this double taxation by allocating between the contracting states the taxing jurisdiction over such income and by providing mechanisms for the relief of any residual double taxation. Treaties also typically require tax laws to be applied without discrimination based on nationality or capital ownership or against the conduct of business through a permanent establishment.

37. Treaties, therefore, offer significant reassurance and certainty to potential investors, as well as greater certainty for the tax administrations, by reducing the risk of cross-border disputes.

38. In considering whether to make the negotiation of tax treaties a priority, developing countries may wish to weigh these advantages against the resources and the balance of bilateral concessions required.

4.1.2 Interpretive procedures

39. Tax treaties also provide the mutual agreement procedure, a cross-border dispute resolution mechanism that is available exclusively by treaty. Operated by designated tax administration officials of each country who are referred to as "competent authorities," the mutual agreement procedure enables tax administrations to reach bilateral agreement on issues of general interpretation or application and thereby avoid double taxation on cross-border transactions and the resulting disputes. These bilateral agreements may relate only to past years, or they may take the form of advance pricing agreements (APAs) that provide a transfer pricing methodology for future years (and, in many cases, past years as well). As discussed at 6.1, below, the mutual agreement procedure also applies to resolve cross-border disputes that have arisen in particular cases.

4.1.3 Other procedural provisions

40. Some treaties also contain other procedural provisions, either in the treaty or in accompanying guidance agreed between the treaty partners, to ensure smooth implementation and consistent application on a bilateral basis. For example, guidance may be provided on how taxpayers may claim the benefits of the treaty to which they are entitled at source, to minimize the need for refund claims and the associated burdens on taxpayers and tax administrations. Such guidance typically has not focused on transfer pricing, because many countries have historically relied heavily on the guidance provided by the Transfer Pricing Guidelines. While the application of multilateral guidance is generally preferable, where possible, for

reasons of consistency, treaty negotiators may wish to address specific bilateral issues, or reconcile differing multilateral approaches, by providing bilateral procedural guidance where necessary.

41. Developing countries may also want to consider participating in joint audits. Such joint audits have recently been embraced by South Africa, for example, together with developed country tax administrations. They are conducted by two or more tax administrations together to share information, save resources, and minimize, or expedite the resolution of, controversies. Joint audits are still relatively new procedures, but they may prove useful for developing country tax administrations with fewer resources and less experience or subject-matter expertise in the industry or issues concerned.

4.2 Multilateral Agreements

4.2.1 Interpretive guidance

42. Multilateral agreements are important tools to avoid cross-border disputes on transfer pricing and the resulting risks of unrelieved double taxation.

43. As noted above, many countries have historically relied primarily on the guidance provided by the Transfer Pricing Guidelines, which interpret Article 9 (Associated Enterprises) of the OECD Model Convention and have been developed by transfer pricing experts over the past several decades. A number of economies in transition and developing countries have adopted domestic transfer pricing laws that take the provisions of the Transfer Pricing Guidelines into account to a large extent. These include, for example, China, Egypt, India, Malaysia, and South Africa.

44. Although the provisions of Article 9 of the UN Model Convention are very similar to the corresponding OECD Model provisions, the interpretation provided by the Transfer Pricing Guidelines may not be fully consistent with the policy positions of all developing countries. However, in recent years, representatives of China, India, and other non-OECD economies have begun participating actively as observers in the development of transfer pricing guidance at the OECD. The Commentary to Article 9 of the UN Model also recommends the Transfer Pricing Guidelines to countries generally. Therefore, developing countries may wish to consider the potential relevance of the Transfer Pricing Guidelines, along with the growing body of UN guidance and other available sources, when establishing their own domestic and cross-border policies on transfer pricing.

4.2.2 Procedural provisions

45. This manual contains much useful procedural guidance that should help avoid disputes, particularly in its discussion of tax audits.

5. Dispute Resolution Mechanisms – Domestic

5.1 Audit Settlements

46. Many developing country tax administrations rely heavily on case-by-case audit settlements to resolve disputes with taxpayers. While this may seem like the most effective use of limited resources, this approach is not transparent, is not necessarily coordinated to provide similar treatment to similarly situated taxpayers, and is, therefore, not always perceived as fair by stakeholders. It may also raise more integrity issues than some other mechanisms.

47. Developing countries seeking to reassure current and potential investors would be well-advised to develop the supplemental domestic dispute resolution mechanisms discussed below, in addition to cross-border mechanisms where possible.

5.2 Administrative Appeals

48. A well-designed administrative appeals procedure can help ensure that the tax administration resolves its disputes with taxpayers in an efficient and fair manner. This will provide an added level of assurance to investors.

49. To operate well and be perceived as fair, an appeals function must be independent of other parts of the tax administration, so that it can provide an independent review of the dispute. It may not be as effective, from an institutional perspective, to have the case heard by peers of the colleagues whose assessments are being appealed.

50. Countries seeking to avoid integrity issues may wish to consider using panels of decision-makers, as in India's Dispute Resolution Program, or implementing additional levels of reviews, as in Nigeria's rulings practice.

5.3 Judicial System

52. An independent judicial system that gives unbiased consideration to cases can do much to improve a country's reputation among investors as a jurisdiction where tax disputes can be fairly resolved.

53. However, because of the call in the modern business world for real-time certainty regarding tax obligations, the perceived benefit of such a judicial system declines as the length of time to obtain a final decision grows. It is, therefore, important to ensure that the judicial system has adequate resources and that it is not unduly burdened by tax disputes due to real or perceived deficiencies at the audit and administrative appeals stages.

6. Dispute Resolution Mechanisms – Cross-Border

6.1 Mutual Agreement Procedure (MAP) Under Tax Treaties

6.1.1 Overview of MAP procedures

54. The new UN Commentary on Article 25 (Mutual Agreement Procedure)[2] provides much valuable guidance on dispute resolution through the MAP procedure, which is relevant for both transfer pricing and other disputes.

55. The UN Committee of Experts is developing a Guide to the Mutual Agreement Procedure Under Tax Treaties, which will provide additional guidance on best practices in the structuring and operation of MAP programs, based on practical experience, which developing countries may wish to evaluate and draw upon.[3]

56. Some tax administrations, including those of Canada, Germany, Japan, the Netherlands, and the United States [**add links and mention any others**], have published detailed internal MAP procedures. These may also provide useful comparative information for tax administrations with less MAP experience to date.

57. It is useful for tax administrations to indicate their intention to follow published guidelines or to publish their own MAP procedures. This promotes consistency in case handling and transparency regarding the expectations of the tax administration.

6.1.2 Structural considerations

58. The purpose of the MAP program is to provide an effective means of reconciling differing positions of treaty partners, so that the treaty can operate as intended to avoid double taxation or other taxation not in accordance with the provisions of the treaty. Experience has shown that this purpose can best be achieved if the MAP program is structured so that tax administrators implementing the MAP program are able to make decisions independently of those implementing the audit program and are free from political influence.

59. Structural independence can be more difficult to achieve in smaller tax administrations, which may have a limited number of subject matter experts available to advise on issues. Where, because of resource constraints, the same subject matter experts must be used for both audit and MAP programs, it will be important to provide a mechanism for effective independent review of proposed MAP positions in order to ensure that they are not unduly influenced by the views of auditors.

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[2] The current draft is E/C.18/2011/CRP.4 at http://www.un.org/esa/ffd/tax/seventhsession/index.htm.

[3] [Insert cite to new draft when posted on UN website.] Tax administrations may also want to refer to the OECD Manual on Effective Mutual Agreement Procedures, available at http://www.oecd.org/document/26/0,3746,en_2649_37989739_36197402_1_1_1_1,00.html.

60. Freedom from political influence on the MAP process is equally important. Many tax administrations have found that this can be best achieved this by placing the MAP function within the tax administration, rather than within the Ministry of Finance or other tax policy-making function. It is helpful to establish procedures or practices preventing involvement by those outside of the tax administration in decisions regarding particular MAP cases. In the United States, for example, the Department of the Treasury follows a long-standing policy of not intervening in particular MAP cases, even when asked to do so by taxpayers or their representatives, and carefully limits its involvement in MAP matters to general policy-level procedural issues.

6.1.3 Operational considerations

61. Given their purpose, it is important for MAP procedures to be operated in a consistent manner, rather than handling each case in an *ad hoc* fashion. This will provide for similar treatment of similarly situated taxpayers and help the MAP program be viewed as equitable and effective. Both operational structure and training and other capacity building of the workforce can play an important in promoting such consistency.

62. For similar reasons, it is important for a MAP program to apply principled approaches to resolving cases. In the first instance, the approaches taken should be consistent with the provisions of the treaty and any relevant interpretive guidance. It is essential that foreign and domestic taxpayers and "inbound" and "outbound" transactions be treated in the same manner. This will help produce consistent, predictable results and further contribute to a view of the MAP program as equitable and effective. Training and other capacity building will be important for this purpose as well.

63. It is also essential to implement a policy of broad access to MAP, if it is to serve the purpose of resolving cross-border disputes and be regarded by potential investors as equitable and effective. This calls for the elimination of factors that could otherwise prevent or discourage the use of MAP, including unreasonable time limitations or unilateral attempts to exclude selected issues from MAP. Consideration should be given to suspending the collection of disputed tax assessments on cases pending in MAP, which can otherwise present serious cash flow difficulties for taxpayers that have already paid tax on the same amount in the other country. If necessary, this can be done in exchange for a bank guarantee to ensure the payment of the tax due upon the conclusion of the MAP procedure, as provided, for example, in India's bilateral agreements with the United Kingdom and the United States. Similarly, consideration should be given to preventing the imposition of interest or, at a minimum, higher interest rates that may effectively operate as penalty measures, while cases are pending in the MAP program.

6.2 Advance Pricing Agreements (APAs)

6.2.1 Policy considerations

64. Since the initiation of APA programs in the early 1990s by Japan and the United States, many tax administrations have found APAs to be an effective tool for providing transfer pricing guidance in advance to taxpayers and greater certainty to both tax administrations and taxpayers. Some of the most active advocates of APA programs have been OECD member countries that generally favor taxation at source, such as Australia, Canada, and Korea. China began negotiating bilateral APAs several years ago, and India has announced that it will implement a bilateral APA program beginning in April 2012.

65. APAs have been used in many cases to resolve disputes for past years as well, sometimes addressing a total of ten or more years at one time. They can, therefore, be an effective use of resources, especially for large or complex cases. In many countries, taxpayers tend to have a particularly strong preference for APAs over litigation.

66. Tax administrations generally find APAs to be a more amicable process than the audit process followed by a MAP. To the extent that there is advance agreement on key transfer pricing issues, neither country faces the prospect of refunding taxes already collected.

67. Because the taxpayer provides extensive information in advance, the APA process can be more efficient than the audit function in determining the relevant facts. Perhaps for this reason, many tax administrations have a general practice of suspending examination activity during APA discussions.

68. Tax administrations have also found APAs to be good tools for developing a deeper understanding of business operations, which can be used to inform their general guidance and examination processes. Most administrations have found that APAs are more widely embraced if they keep APA and examination functions separate, or impose limitations on the use of some or all of the information provided by the taxpayer in the APA discussions for other purposes, such as subsequent examinations or future litigation if an APA cannot be successfully concluded.

69. On the other hand, tax administrations with severe resource limitations will need to weigh the advantages of APAs against other demands for resources. It may be difficult for a tax administration that is still developing its general audit capabilities to feel comfortable diverting substantial resources to an APA program at that stage. Such countries may also be concerned that they will be at a disadvantage in negotiating APAs with multinational enterprises or more experienced countries until it develops more experience, including with MAP cases.

70. These countries may wish initially to limit the terms of their APAs (perhaps to three years rather than the five years more commonly used by experienced countries), so that they can evaluate the experience more quickly and adjust their practices if desired. Or they may wish to negotiate a few APAs in a pilot program, before committing themselves to a generally available, permanent program. Alternatively, inexperienced countries may choose to do APAs first on a unilateral, rather than a bilateral, basis. It should be noted, however, that a unilateral APA does not necessarily produce results that are acceptable to other countries and is, as a result, less reassuring to potential investors seeking protection from double taxation.

6.2.2 Developing and operating an APA program

71. It is important to establish an appropriate operational framework for an APA program, to promote a consistent, principled approach and ensure adequate review.

72. Ideally, APA programs should be established with dedicated, trained staff, to maximize the benefits of experience and to promote an attitude of cooperation and transparency. If, due to resource limitations, APA programs need to draw on expertise from other parts of the tax administration, it is important to establish safeguards to ensure that the APA process is not managed in the same manner as a typical audit proceeding. Otherwise, many of the benefits typically enjoyed by tax administrations in APA proceedings may be lost.

73. At the same time, it is important to ensure that the APA program operates in an appropriate manner within the framework of the tax administration as a whole. Procedures should be set up, for example, to prevent the APA program from being used primarily to challenge the position of an audit team for past years. This may be achieved, for example, by requiring that the APA apply primarily to future years rather than past years.

74. Organizationally, most tax administrations have tended to manage their APA programs together with their MAP programs, and to organize them so that all cases with a particular treaty partner are handled by the same team. This facilitates the formation of closer working relationships between the teams from the two countries, and promotes a better understanding of the other country's economy, legal provisions, and administrative procedures. On the other hand, benefits may also be derived by comparing experiences on cases within an industry sector or by comparing the approaches of various treaty partners to similar issues. It is important to establish procedures for facilitating the sharing of such knowledge as well, to strengthen technical analysis and provide consistent treatment.

75. Most tax administrations have found that an APA term of approximately five future years strikes the best balance between efficient use of resources and the uncertainties associated with prospective agreements. The risks associated with uncertainties can be minimized by specifying certain conditions (sometimes referred to as "critical assumptions") in which the APA will be renegotiated. It is fair to expect a renegotiation if the applicable law or the covered transactions change

materially, but care should be taken not to impose excessively strict requirements on the continued application of an APA.

76. A tax administration's resources normally are best used to conclude APAs on complex issues. However, in the interest of fairness to smaller taxpayers who also need certainty, tax administrations may wish to consider establishing special simplified APA procedures for smaller taxpayers.

77. Some administrations charge taxpayers user fees for the conclusion of APA, as a means of funding the program. If reasonable in amount, these have generally been accepted by taxpayers as outweighed by the advantage of the certainty provided by the APA. To avoid integrity issues, it is important that the fees be charged on a consistent basis (ideally reduced for small taxpayers), that they are paid into government funds, and that they are refunded in the rare circumstances where an APA cannot be concluded.

78. The Guide to the Mutual Agreement Procedure Under Tax Treaties provides much guidance on best practices in the structuring and operation of APA programs.[4]

79. Some tax administrations, including those of Canada, Japan, and the United States [**add links and mention any others**], have published detailed internal APA procedures. These may also provide useful comparative information.

6.3 Other Dispute Resolution Programs

6.3.1 Mediation / conciliation

80. Mediation and conciliation are sometimes mentioned as potential mechanisms to resolve cross-border disputes. Mediation has proven successful in resolving disputes within some EU member states. While it may be worth testing these approaches, it is not clear that they can be effective in a cross-border context. The negative experiences of countries that have adopted voluntary arbitration provisions, in which either country may decline to participate or to accept the arbitration decision, might indicate that other voluntary procedures such as mediation or conciliation are not likely to be generally successful.

6.3.2 Arbitration

81. Mandatory arbitration provisions have been added to many treaties in recent years as a last resort method of resolving MAP issues that cannot be resolved by the competent authorities within a specified time frame. The European Union began this trend in 1990 with the multilateral EU Arbitration Convention and the OECD

[4] [Insert cite.] Tax administrations may also want to refer to the Manual on Effective Mutual Agreement Procedures, at http://www.oecd.org/document/26/0,3746,en_2649_37989739_36197402_1_1_1_1,00.html.

amended its Model Convention and Commentary in 2008 to recommend the inclusion of mandatory arbitration provisions in bilateral tax treaties.

82. Current OECD statistics show that the MAP process succeeds in avoiding double taxation in 90 to 95 percent of the cases to which its member countries are a party. While that is an impressive success rate for a dispute resolution program that does not legally require the parties to reach agreement, the risk of double taxation in the remaining cases is still a serious concern for taxpayers, especially given the growing amounts in controversy. Although taxpayers, like competent authorities, generally prefer to avoid arbitration, the inclusion of arbitration provisions in treaties has been widely supported by taxpayers because they guarantee a resolution within a specified time frame and thus provide certainty that double taxation will be avoided.

83. In the vast majority of cases, the practical effect of mandatory arbitration provisions has been to encourage the competent authorities to reach agreement by the specified deadline. Only a handful of cases out of many hundreds of MAP cases submitted have been submitted to arbitration under agreements concluded thus far.

84. Mandatory arbitration provisions have already been added to many treaties between OECD member countries, even where one country has a general preference for residence-based taxation and the other a general preference for source-based taxation. However, at the 2010 Annual Session of the UN Committee of Experts on International Co-operation in Tax Matters, most participants from developing countries expressed potential interest in tax treaty arbitration procedures for the future but a reluctance to adopt arbitration at this time, leading the Committee to endorse arbitration as an option but not an affirmative recommendation.

85. As reflected in the new UN Commentary on Article 25, members of the UN Committee have identified arguments both in support of and against the adoption of mandatory tax treaty arbitration by developing countries, which are summarized below together with other considerations that have been identified by members of the Subcommittee on Transfer Pricing.

86. It has been suggested that mandatory tax treaty arbitration may have the following potentially negative consequences from a developing country perspective:

- Developing countries may feel compelled to agree in MAP in order to avoid arbitration, because they cannot afford the costs and foreign exchange requirements of arbitration proceedings. This is on the basis that, unlike in a court case, the parties to the dispute will pay not just for legal expenses but also for other expenses, which may include the facilities, the arbitrator, the arbitrator's assistants, air fares accommodation in hotels, translators and so forth. They will also often be required to pay at least the arbitrator's fees in a foreign currency;
- Positive experiences of arbitration clauses helping force an agreement may be useful in the developed country context, but may be more problematical in cases where one party may have real difficulties in funding and otherwise resourcing an arbitral hearing;

- Developed countries may have better legal representation in arbitration proceedings than developing countries can afford, especially in terms of familiarity with arbitrations;
- It may be difficult to find arbitrators sufficiently familiar with developing country concerns and issues, much less those actually from developing countries,;
- It may be difficult to find arbitrators without ties to one side or the other or who are not advisors to taxpayers on similar issues; and
- Arbitration may raise sovereignty concerns, either in terms of achieving sufficient support at the political level for adding such an obligation, or in terms of whether it is constitutionally possible to bind one's country to an arbitrated result.

87. Those who support the inclusion of mandatory arbitration provisions in tax treaties have argued that it will have the following benefits for developing countries and can be designed in the following ways to address their concerns:

- The inclusion of arbitration provisions would send a strong signal to reassure current and potential investors that the country is committed to avoiding double taxation;
- Experience shows that the great majority of MAP cases will not go to arbitration in any event, so the costs of arbitration may not be significant, especially for countries with few MAP cases;
- Arbitration may well save resources overall because it should accelerate the resolution of MAP cases and provide taxpayers in difficult cases with a preferable alternative to litigating their issues; There are ways of designing the arbitration procedure to minimize costs, such as adopting streamlined "last best offer" arbitration procedures, permitting government officials who have not been involved in the case to serve as arbitrators, limiting the number of arbitrators, and/or limiting their face-to-face meetings. Costs could also be allocated more heavily towards developed countries and could perhaps even be funded centrally through the UN, with donor (government or other) support, although no such mechanism currently exists;
- If a developed country's position is technically weak, an independent arbitrator may be better able to see that than a less experienced developing country competent authority analyst. Therefore, arbitration may be a way of leveling the playing field for developing countries;
- Advocates of arbitration believe that there are sufficient qualified, independent arbitrators, including experts from developing countries. The new UN Commentary on Article 25 permits the competent authorities to ask the UN Committee of Experts on International Co-operation in Tax Matters to develop a list of persons considered qualified to serve as arbitrators, if desired; and

- As currently adopted in many bilateral treaties, arbitration operates as an added step in the treaty's MAP procedure, to resolve disputes that the competent authorities are not able to agree on with the specified period. Advocates of arbitration do not view this as raising sovereignty concerns, because the MAP procedure is itself contemplated by the treaty.

88. In view of these differences in view, the new UN Commentary proposes to add arbitration under one version of Article 25, with certain adjustments to the OECD approach to address issues that have been identified by developing countries. Transfer pricing issues were at the forefront of discussion on arbitration issues in the Committee, so the results of those discussions are especially relevant in this area.

7. Coordination of Domestic and Cross-Border Dispute Resolution Mechanisms

89. Each country will have its own domestic dispute resolution mechanisms in addition to cross-border mechanisms. It is important for two reasons that these be properly coordinated.

90. First, tax administrations, especially developing country administrations with limited resources, may want to minimize duplication of effort by avoiding the simultaneous operation of two parallel dispute resolution processes.

91. Second, notwithstanding resource concerns, it is important to manage any duplication issues without forcing taxpayers to make a premature choice between domestic and cross-border mechanisms. For example, taxpayers should not be required to cede their MAP rights under treaties in order to access domestic administrative appeals procedures. To avoid such results while addressing resource constraints, many tax administrations permit taxpayers to preserve their rights to domestic procedures during MAP discussions, so that they can later pursue their domestic rights if no MAP agreement is reached. Alternatively, tax administrations may wish to provide flexibility in the timing of MAP procedures, by not setting a deadline for MAP requests under their treaties or domestic laws, so that appropriate domestic procedures can be explored first.