Chapter C4

DISPUTE AVOIDANCE AND RESOLUTION

C.4.1. Introduction

C.4.1.1. Dispute avoidance and resolution procedures are essential to the effective and efficient functioning of all tax administrations. Such procedures, if properly designed and implemented, can enable fair and expeditious resolution of differences between tax administrations and taxpayers regarding interpretation and application of the relevant tax laws. They can help reduce the uncertainty, expense and delay associated with a general resort to litigation on tax matters or a failure to provide any recourse. They can also avoid integrity issues that might be sometimes arise in case of an over-reliance on ad hoc (case by case) settlements. For the reasons mentioned above dispute avoidance and resolution procedures are of critical importance to taxpayers and access to effective procedures is therefore a key consideration for taxpayers.

C.4.1.2. The goal of dispute avoidance and resolution procedures is to facilitate the efficient and equitable determination and collection of tax revenues that are properly due. Ideally, this determination and collection should be done in ways that minimize controversy, cost, uncertainty and delay for both tax administrations and taxpayers. The most efficient method of addressing disputes is to prevent them from arising. Tax administrations seeking to use their resources most efficiently should therefore probably focus in the first instance on procedures for avoiding disputes while subsequently ensuring that appropriate dispute resolution procedures are available, should they become necessary.

C.4.1.3. In the cross-border context, dispute avoidance and resolution procedures are particularly important to avoid double taxation of the same income for a taxpayer or for associated enterprises. These procedures can also help avoid the imposition of tax not in accordance with the provisions of the applicable tax treaty, if any. When a tax treaty applies both tax administrations involved in a tax dispute ought to give effect to the provisions of that tax treaty and ought to provide rules and procedures for departing from the domestic law result where necessary to resolve disputes.

C.4.2. Special Considerations for Developing Countries

C.4.2.1. According to Mutual Agreement Procedure (MAP) data for OECD countries and some partner economies[1] available at the OECD website[2] the global number of MAP disputes has been rising rapidly. However, tax administrations often face resource limitations regarding the handling of (cross-border) tax disputes and-such limitations may be even greater for the tax administrations of many

[1] The partner economies referenced here are Argentina, China, Costa Rica, Latvia and South Africa according to the OECD MAP statistics. See link in footnote 2 infra.

2 See http://www.oecd.org/ctp/dispute/map-statistics-2006-2014.htm.

developing countries. Such limitations may affect staffing levels, training budgets, access to commercial databases needed for transfer pricing analyses and other research materials, access to outside experts, travel funding and other factors. It should be recognized that such resource limitations may put tax administrations at a real (or perceived) disadvantage when dealing with better-resourced administrations. Therefore it is particularly important for developing countries that dispute avoidance and resolution procedures be designed to operate as efficiently as possible, to minimize the demand on tax administration resources.–Efficient dispute avoidance and resolution procedures should benefit taxpayers as well. Access to properly functioning dispute avoidance and resolution procedures is particularly important for multinational enterprises as they are called on to comply with the tax laws and reporting requirements of many dozens of countries and may need to address ~~any~~ audits or disputes that may arise in any of the countries where they do business.

C.4.2.2. There are various administrative procedures that could be applied to minimise transfer pricing disputes and to help resolve them when they do arise between taxpayers and their administrations, and between different tax administrations. As indicated earlier, where two or more tax administrations take different positions in determining arm's length conditions, double taxation may occur. This means that the same income is included in the taxable base by more than one tax administration. Double taxation is undesirable and should be eliminated wherever possible, because it constitutes a potential barrier to development of international trade and stated investment flows.

C.4.2.3. This chapter discusses several administrative approaches to resolving disputes caused by transfer pricing adjustments and for avoiding double taxation. The respective procedures all call upon domestic tax administration resources. If resource mobilization is a key concern or limiting factor for a country's tax administration it should consider the approaches that can be realistically made available, are appropriate, and investments that may be required to expand the available dispute resolution procedures. An additional factor to consider are the evolving international institutional cooperative developments regarding international dispute resolution.

C.4.3. Dispute Avoidance Procedures: Domestic

C.4.3.1. Legislation and Guidance

C.4.3.1.1. As in other areas of the law, clear guidance in advance regarding any legal transfer pricing requirements that apply can serve to reduce tax disputes. This is equally important both 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 and therefore help minimize controversy.

C.4.3.1.2. Guidance can serve these purposes only if it is clear and detailed enough to be properly 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.

C.4.3.1.3. 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.

C.4.3.1.4. Developing countries whose tax systems are at an early stage of development or who 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 OECD 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 a country decides to adopt a simplified approach it may be advisable to re-evaluate that decision periodically. A simplified approach may not continue to meet the needs of the tax administration as it addresses more complex transactions, or the approach may no longer be needed for practical reasons.

C.4.3.1.5. The setting of legislative priorities is obviously a matter for each country to decide for itself, in view of its particular circumstances and policies. Transfer pricing legislation may, for example, 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.

C.4.3.1.6. However, where a country that has not adopted specific transfer pricing legislation decides that it is appropriate to challenge a company's inter-company 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 inter-company pricing on this basis.

C.4.3.1.7. Such an approach may also raise issues of fairness to the taxpayer, if the application of general principles to inter-company pricing is not sufficiently clear and predictable. In such a case, this lack of certainty may create significant controversy.

C.4.3.1.8. Due to the above-mentioned considerations it is normally advisable for developing countries to adopt transfer pricing guidance as soon as they are in a position to do so and to examine transfer pricing practices to the extent possible.

C.4.3.2. Tax Audit Practices and Domestic Tax Policies

C.4.3.2.1. Tax audit practices and policies play a key role in any effort by a tax administration to avoid or minimize disputes with taxpayers. –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. Conversely, where a tax administration has systemic integrity

or confidentiality issues or applies the law in a manner that is not seen as fair and equitable, or is regarded as unpredictable, taxpayers are more likely to see a need to seek resolution of the dispute elsewhere. All tax administrations seeking to avoid or minimize disputes with taxpayers should therefore 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 C.3. of this Manual.

C.4.3.2.2. Tax administrations may ~~also~~ find it useful to consult the practical guides and information publications issued by tax administration organizations such as the Inter-American Center of Tax Administrations (CIAT)[3] and the OECD's Forum on Tax Administration (FTA).[4]

Advance Rulings

C.4.3.2.3. Some countries have a practice of issuing advance rulings regarding the application of a country's laws to a taxpayer's particular facts (sometimes structured as unilateral Advance Pricing Agreements (APAs) in some countries. These are discussed in more detail below in the section on cross-border dispute avoidance procedures).[5] These advance determinations can often be very helpful in avoiding disputes between that taxpayer and the tax administration.

C.4.3.2.4. When considering new issues tax administrations may initially prefer to provide guidance by a system of case-specific rulings so that they have an opportunity to consider the issues more fully before committing themselves to a general approach. On the other hand where the issue is one of general application it may be more efficient for the tax administration to issue general guidance.

C.4.3.2.5. A heavy reliance on ad hoc rulings may also give rise to integrity concerns and associated equity issues unless there is a robust ruling review process in place. Where guidance is routinely provided by way of rulings it may prove difficult to strike an appropriate balance between legitimate taxpayer confidentiality concerns and the level of transparency that may be desired to issue an effective ruling. While it is generally best practice to maximize transparency it would normally 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 if these taxpayers operate 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

---

3 More information (in English and Spanish) available from http://www.ciat.org/index.php/en.html. CIAT publications cover all matters related to taxation and tax administration. Information on CIAT's e-learning programme is available from http://www.ciat.org/index.php/en/products-and-services/training.html

4 A list of recent OECD publications giving guidance to tax administrations is available from http://www.oecd.org/ctp/administration/List-of-publications.pdf. The Forum on Tax Administration's compilation covers both direct and indirect tax issues, for enterprises of all sizes and high net worth individuals, and includes 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.

5 Advance Pricing Agreements are discussed in paragraph C.4.4.2.2. infra.

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

C.4.3.2.6. An alternative means of promoting transparency and consistent treatment of taxpayers, reportedly used by Nigeria, for example, is to publish generally applicable guidance on issues of broad application after analyzing them in a cooperative relationship process with a particular taxpayer. Another possibility would be consultation processes with the business or industry sectors involved.

Cooperative Relationships

C.4.3.2.7. In addition, tax administrations may wish to consider whether they should move towards a more cooperative relationship (sometimes referred to as an "enhanced relationship") with some taxpayers and their advisors in order to get a better understanding of their business and transfer pricing practice. The Netherlands and the United Kingdom are widely seen as having already successfully implemented cooperative relationship programmes and other countries (such as Nigeria) are currently testing this approach.

C.4.3.2.8. A cooperative relationship can benefit tax administrations and taxpayers by offering greater certainty and transparency, an earlier and more efficient discussion on and resolution of any tax issues and lower administrative and compliance costs. It can also be used to resolve tax disputes or uncertainties for prior years more efficiently.

C.4.3.2.9. From a tax administration perspective interest in a cooperative relationship follows from the understanding that:

- Effective risk management requires current, relevant, and reliable information regarding the taxpayer's facts and potential tax issues, for which the taxpayer is the best source;
- A cooperative relationship makes the collection of any taxes owed more efficient, saving audit and litigation resources; and
- Tax payments will be received more quickly if disputes are avoided or resolved early in the process.

C.4.3.2.10. From the taxpayer's perspective a cooperative relationship may be worthwhile because it can:

- Provide greater certainty and predictability regarding the taxation of the taxpayer's investments, which is essential especially where significant investments are being considered;
- Expedite the resolution of tax issues; and
- Save costs by streamlining compliance and dispute resolution processes.

C.4.3.2.11. A cooperative relationship initiative tends to be administration resource intensive, however, and must be carefully implemented to ensure the consistent application of legal provisions, to protect taxpayer rights and to avoid integrity issues. While the manner in which tax administrators, taxpayers and tax advisors deal with each other is modified, applicable tax provisions should continue to be applied impartially. It is also important to implement cooperative relationship initiatives efficiently so that adequate audit resources can be devoted to less compliant taxpayers.

C.4.3.2.12. Development of a successful cooperative relationship requires that all parties engage on the basis of the following parameters:

- A genuine commitment to developing a relationship of mutual trust;
- A transparent and open approach;
- An understanding of commercial and industry aspects;
- An implementation process agreed at the start, including the designation of responsible persons at relevant levels of both the tax administration and the taxpayer; and
- Clear agreement in advance on the period to be covered.

C.4.3.2.13. Tax administrations may find it useful to adopt an industry-based focus where feasible, so that the experience gained can be leveraged and used to provide consistent and transparent treatment to similarly situated taxpayers (taking relevant differences into account).

Audit Settlements

C.4.3.2.14. Many tax administrations, both developing and developed, rely heavily on case by case audit settlements to resolve disputes with taxpayers. To the extent audit settlements are based on clarifications and better understandings of relevant facts, this may be an effective use of limited resources. A disadvantage of audit settlements is that such an approach of dispute resolution is often not very 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 concerns than some other dispute settlement procedures.

C.4.3.2.15. Developing countries seeking to reassure current and potential investors should consider developing, improving or supporting the supplemental domestic dispute resolution procedures discussed below, in addition to cross-border procedures where possible.

C.4.3.3. Formal Domestic Dispute Resolution Procedures

Administrative Appeals

C.4.3.3.1. 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. To operate well and to be perceived as fair, an appeals procedure 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 the persons responsible for issuing the assessments or by their peers.

C.4.3.3.2. Countries seeking to avoid integrity issues may wish to consider using panels of decision-makers, as in India's Dispute Resolution Panel programme, or implementing additional levels of reviews as in Nigeria's rulings practice. Brazil's Administrative Court of Tax Appeals (CARF) is an example of a successful administrative appeal procedure. Appeals are processed in three steps, the first step being within the tax administration while the second (the appeal) and the third (the special appeal, which is accepted under certain conditions) are decided by the CARF. The CARF is housed within the Ministry of Finance but is separate from the tax administration, even though that is part of the same ministry.

Mediation/Conciliation

C.4.3.3.3. Mediation and conciliation are sometimes mentioned as potential procedures to resolve disputes. Mediation has proven successful in resolving tax disputes within some EU Member States, e.g. The Netherlands and the United Kingdom. The most significant benefit of this approach towards dispute resolution is seen as the quick time frame within which disputes have been resolved. The mediation option may be made available as an administrative process within the tax administration, rather than as a separate independent mediation procedure outside of the administrative process. The process may be particularly promising in those situations where the tax auditor and taxpayer are no longer willing to communicate with each other and mutually resolve a dispute. In this environment, a mediator may be able to help overcome relationship challenges that prohibit the parties from reaching an agreement. While it may be worth testing these approaches it should be noted that they are not automatically effective in a cross-border context, as they would still require an additional administrative step to obtain avoidance of double taxation. Potential utilization of similar processes in the treaty dispute resolution process is noted in paragraph C.4.4.1. below.

Judicial System

C.4.3.3.4. An independent judicial system that gives unbiased consideration to (tax) cases can do much to improve a country's reputation among investors as a jurisdiction where tax disputes can be fairly resolved.

C.4.3.3.5. However owing to 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.

C.4.4. Dispute Avoidance Procedures: Cross-Border

C.4.4.1. Tax Treaty Provisions

Division of taxing jurisdiction

C.4.4.1.1. 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 procedures 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 and without discrimination against the conduct of business through a permanent establishment.

C.4.4.1.2. Treaties therefore offer significant reassurance and certainty to potential investors, as well as greater certainty for tax administrations, by reducing the risk of cross-border disputes. In considering whether to make the negotiation of tax treaties a priority and which treaty negotiations to prioritize,

developing countries may wish to weigh these advantages against the resources and the balance of bilateral concessions required to achieve an agreed treaty.

The mutual agreement procedure

C.4.4.1.3. Tax treaties also provide for a Mutual Agreement Procedure (MAP); a cross-border dispute resolution procedure found at Article 25 of both the UN and OECD Model Tax Conventions. Operated by designated tax administration officials of each country who are referred to as "competent authorities", the MAP enables tax administrations to reach bilateral agreement on issues of general interpretation or application and to thereby avoid double taxation on cross-border transactions and the resulting disputes. The MAP procedure is separate from, and additional to, domestic law remedies to resolve disputes. However, in many countries domestic law (and in particular a final court decision) can limit available solutions under MAP.

C.4.4.1.4. These bilateral agreements may relate only to past years, or they may take the form of Advance Pricing Agreements (APAs) that provide for agreement on a transfer pricing methodology for future years (and in many cases past years as well). The MAP also applies to resolve cross-border disputes that have arisen in particular cases.

C.4.4.1.5. The UN Commentary on Article 25 (Mutual Agreement Procedure) provides a great deal of guidance on dispute resolution through the MAP procedure, which is relevant for both transfer pricing and other disputes. The UN Committee of Experts has adopted a Guide to the Mutual Agreement Procedure under Tax Treaties, which provides additional guidance on best practices in the structuring and operation of MAP programmes based on practical experience, which developing countries may wish to evaluate and draw upon.[6]

C.4.4.1.6. Some tax administrations, including for example those of Canada,[7] Germany, India, Japan,[8] The Netherlands, the United States[9] and the United Kingdom,[10] as well as the Pacific Association of Tax Administrators (PATA)[11] have published detailed internal MAP procedures. These may also provide useful comparative information for tax administrations that wish to learn more about the MAP. 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

---

[6]The Guide is available from http://www.un.org/esa/ffd/tax/gmap/Guide_MAP.pdf Tax administrations may also want to refer to the OECD Manual on Effective Mutual Agreement Procedures (MEMAP) available from http://www.oecd.org/ctp/dispute/manualoneffectivemutualagreementproceduresmemap.htm The aim of the MEMAP is to make available to tax administrations and taxpayers basic information on the operation of the MAP under bilateral tax treaties and to identify best practices for MAP.

[7]More information available from
http://www.cra-arc.gc.ca/tx/nnrsdnts/cmp/mp_rprt_2014-2015-eng.html

[8]More information available from
https://www.nta.go.jp/foreign_language/MAP-Report/2015.pdf

[9]More information available from http://www.irs.gov/irm/part4/irm_04-060-002.html

[10]More information available from http://www.hmrc.gov.uk/international/map.htm

[11]More information available from http://www.irs.gov/pub/irs-utl/pata_map_guidance_-_final.pdf

expectations of the tax administration. It may be advisable to enact provisions in domestic law allowing for MAP and APA procedures and, if necessary (and possible), an amendment to the constitution, in order to provide juridical certainty to such procedures.

C.4.4.1.7. The purpose of a MAP programme 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 programme is structured so that tax administrators implementing the MAP programme are able to make decisions independently of those implementing the audit programme and are free from outside influence.

C.4.4.1.8. Structural independence may be more difficult to achieve in smaller tax administrations, which may have a limited number of subject matter experts available to advise on such issues. Where, because of resource or other constraints, the same experts must be used for both audit and MAP programmes it will be important to provide a procedure for effective independent review of proposed MAP positions in order to ensure that they are not unduly influenced by the views of auditors.

C.4.4.1.9. Freedom from political influence on the MAP process is equally important. Many tax administrations have found that this can be best achieved by placing the MAP function within the tax administration, rather than within the Ministry of Finance or other tax policy-making function. They believe it is helpful to establish procedures or practices preventing involvement by those outside the tax administration in decisions regarding particular MAP cases. Other countries believe that placing the MAP function within the Ministry of Finance is preferable, to reduce undue influence by the tax administration, or to facilitate coordination by policy-makers.

Operational considerations

C.4.4.1.9. 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 programme to be viewed as equitable and effective. Both operational structure and training and other capacity building of the workforce can play important roles in promoting such consistency. For similar reasons it is important for a MAP programme 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 programme as equitable and effective. Training and other capacity building will also be important.

C.4.4.1.10. 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, as these assessments can otherwise present serious cash flow difficulties for taxpayers that have already been taxed 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 any tax due upon the conclusion of the MAP procedure. Similarly consideration should be given to preventing the imposition of interest or at least preventing the imposition of higher interest rates that may effectively operate as penalty measures, while cases are pending in the MAP programme.

C.4.4.1.11. The MAP procedure generally commences with a request by a taxpayer addressed to the designated competent authority of a country for consideration of an issue for dispute resolution and/or relief of double taxation, because the taxpayer believes his tax treatment is not, or will not be, in accordance with the treaty. Alternatively, the process can be initiated because there are questions of interpretation or application of the Convention or to eliminate double taxation in cases not otherwise provided for in the Convention. The MAP process is intended to be used also to resolve economic double taxation, such as in the case of transfer pricing disputes. The case has to be presented to the competent authority of the country where the taxpayer is resident within three years from the (first) time the person is notified (for example by way of a notice of assessment) of the action that will result in taxation not in accordance with the convention. The three-year time limit is determined by the treaty article and may differ in certain cases. The definition of what constitutes (first) "notification" may be provided in domestic regulations. The form of the MAP request to be filed may be prescribed under domestic regulations as well. Alternatively, the commentary to the treaty or the model convention may be consulted in this regard or the OECD MEMAP could also be consulted.

C.4.4.1.12. Once the MAP request has been received, it needs to be ascertained that the foreign competent authority is properly informed as well and that all relevant information to decide and agree on the matter is made available to both competent authorities. Considering the time limit within which competent authorities are expected to address and resolve a filed request, it is relevant to determine if further information is required from the taxpayer(s) involved or not, and if so, to request this information as soon as practicable. It would not be prudent to wait to ask for this information at the last minute and to extend or overrun the time limit provided by the applicable treaty. The competent authorities may wish to meet in person to compare notes on the matter and to explore available solutions or may wish to handle the matter through (electronic) correspondence or a combination of both of those approaches. It is generally understood that the competent authority of the country where the primary adjustment was made that is leading to the double taxation (or taxation not in accordance with the convention), has the burden of proof towards the other competent authority that the primary adjustment is justified. That competent authority traditionally will send a letter (a so-called position paper) to the other competent authority informing the latter of its position with respect to the issue for which the competent authority request was filed. Based on the position paper, the other competent authority can respond and explore to what extent it agrees with the position and is able to provide for avoidance of double taxation or not.

C.4.4.1.13. If the competent authorities agree on a way to avoid double taxation and the taxpayer agrees to the suggested solution as well, a bilateral agreement is entered into between the two taxing authorities and an agreement is entered into between the respective competent authority and taxpayer of the country where the primary adjustment was made. Careful consideration is required on how the solution is to be implemented; in what taxable year and whether the statute of limitations is still open as regards that year in the other jurisdiction; or whether the treaty allows for an override of the domestic statute of

limitation provisions. Consideration should also be given to whether the issue decided is a recurring issue (that applies to later years as well) or not. If the issue is a recurring issue and additional adjustments are to be expected for later years, the taxpayer and competent authorities may wish to explore to what extent they have the authority and means to resolve those years as well, or whether a new MAP request ought to be filed for later years.

Arbitration

C.4.4.1.14. The UN Model Convention provides for an optional treaty text that allows the competent authorities to resolve the matter by way of arbitration, if no solution can be obtained within the time frame provided by the mutual agreement article. If that text is included in the treaty for the avoidance of double taxation, or agreement exists between treaty partners to resort to arbitration pursuant to that article, competent authorities that cannot find an acceptable solution for a dispute within the requisite time frame must invoke the arbitration procedures provided by the UN Model Convention or that may have been agreed to by the treaty partners otherwise.

C.4.4.1.15. 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 amended its Model Convention and Commentary in 2008 to recommend the inclusion of mandatory arbitration provisions in bilateral tax treaties.

C.4.4.1.16. OECD statistics show that the MAP process succeeds in avoiding double taxation in 90 to 95 per cent of the cases to which its member countries are a party. While that is an impressive success rate for a dispute resolution programme 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 and tax authorities, especially given the growing amounts in controversy. Both taxpayers, and competent authorities, tend to view arbitration very much as a last resort method. However, the inclusion of these arbitration provisions in treaties has been widely supported by taxpayers as they guarantee resolution within a specified time frame and provide certainty that double taxation will be avoided. 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 the many hundreds of MAP cases submitted have been taken to arbitration under agreements concluded thus far.

C.4.4.1.17. 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 the UN Committee of Experts on International Cooperation in Tax Matters has endorsed arbitration only as an option and not as an affirmative recommendation. The envisaged arbitration process is described in the Commentary to Article 25 of the UN Model Convention.

C.4.4.1.18. As reflected in the 2011 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. These arguments are summarized below together with other considerations that have been identified by members of the Subcommittee on Transfer Pricing.

C.4.4.1.19. 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 reach agreement in the 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. This may include the facilities, the arbitrator, the arbitrator's assistants, airfares, and 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 to 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 arbitration;
- It may be difficult to find arbitrators who are sufficiently familiar with developing countries' concerns and issues, and even more difficult to find arbitrators that actually are 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.

C.4.4.1.20. Those who support the inclusion of mandatory arbitration provisions in tax treaties have argued that these provisions 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 United Nations, 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 this is the case than a less experienced developing country competent

authority analyst. Therefore arbitration may be a way of levelling the playing field for developing countries;

- Advocates of arbitration believe that there are sufficient qualified, independent arbitrators, including experts from developing countries. The 2011 UN Commentary on Article 25 permits the competent authorities to ask the UN Committee of Experts on International Cooperation 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 resolve within the specified period. Advocates of arbitration do not view this as raising sovereignty concerns because the MAP procedure is itself contemplated by the treaty.

Non-Binding Dispute Resolution Procedures

C.4.4.1.21 The UN Committee of Experts on International Cooperation in Tax Matters in October 2015 approved the formation of a Subcommittee to address, consider and report back to the Committee on dispute avoidance and resolution aspects relating to the Mutual Agreement Procedure, with a view to reviewing, reporting on and, as appropriate, considering possible text for the UN Model and its Commentaries, and related guidance, on a variety of issues, including:

- Options for ensuring the MAP procedure under Article 25 (in either of its alternatives in the UN Model) functions as effectively and efficiently as possible;

- Other possible options for improving or supplementing the MAP procedure, including the use of non-binding forms of dispute resolution such as mediation;

- Exploration of issues associated with agreeing to arbitration clauses between developed and developing countries; and

- The need or otherwise for any updates or improvements to the Guide to the Mutual Agreement Procedure under Tax Treaties.[12]

The Subcommittee was to focus especially on issues affecting developing countries, possible means of addressing them in a practical manner, and possibilities for improving guidance and building confidence in dealing with the issues in this area. The Subcommittee was composed of 30 members, including developed and developing countries, global finance organizations, academics, Civil Society, international organizations and the OECD. Its report to the Committee was presented at the October 2016 session (the "2016 Report").[13]

C.4.4.1.22. The Report reflected:

[12] http://www.un.org/esa/ffd/tax/gmap/Guide_MAP.pdf
[13] http://www.un.org/esa/ffd/wp-content/uploads/2016/10/12STM_CRP4_Disputes.pdf

- Growing political and economic uncertainties, including the anticipated growth of tax controversies in all countries as the need for tax base protection and expansion continues to grow;

- Uncertainty concerning domestic implementation of the BEPS Action items by countries;

- Expected increase in availability of information on the transfer pricing practices of MNEs due to Country-by-Country reporting and the increased use of exchange of information provisions;

- The fact that developing countries are increasingly putting in place sophisticated transfer pricing legislation and creating large business units for tax base protection; and

- Many countries have limited or no experience with MAP processes, which may mean that such countries are potentially losing tax revenue by not entering into a bilateral or multilateral tax dispute resolution framework.

C.4.4.1.23. Subcommittee discussions revealed that limited knowledge of MAP procedures was one of the main reasons, besides capacity constraints, for developing countries' lack of engagement. This has, in some cases, led to a situation where taxpayers do not even attempt to initiate a MAP in some countries. Accordingly, it was concluded that there is a need to return to basics and define the meaning of each dispute resolution mechanism to ensure that every party to a dispute understands what is meant when talking about alternative dispute resolution (ADR). This includes the MAP, mediation, arbitration, and expert evaluation/determination. This could become an update of the UN Guide to the Mutual Agreement Procedure under Tax Treaties with a more case study oriented approach, including examples of all documents to be prepared during the MAP for illustration purposes. It could also lead to a UN handbook on dispute resolution.

C.4.4.1.24. The work of the Subcommittee included the full range of existing procedures for resolving cross-border tax disputes, as addressed throughout this Manual (including advance rulings, cooperative compliance, and MAP procedures, as well as APAs discussed below). The Subcommittee also explored the possibility of expanding such processes to include mechanisms to facilitate the development of the capacity of developing countries with little experience in MAP, drawing upon experience in non-tax commercial areas of dispute resolution.

In exploring such potential processes, the Subcommittee noted several overarching objectives for any such procedure, including:

- It should not interfere with the need for countries to derive an appropriate level of tax revenue from economic activities conducted within their respective borders from their tax base;

- It should not affect countries' ability to conduct examinations and make assessments based on the application of internationally agreed standards for transfer pricing and other rules and principles of international tax law;

- It should promote an "investment climate" in which the taxation of cross-border investments is predictable, by enhancing the effectiveness of tax treaties and reducing double taxation; and

- It should provide reassurance to competent authorities participating in dispute resolution that these processes are not overly burdensome, and are efficient and fair, also taking into account the different levels of experience and the unequal capacities of countries with MAP and related procedures.

C.4.4.1.25. During the first meeting of the Subcommittee, non-binding dispute resolution ("NBDR") was proposed as a means of improving the efficiency of the MAP, while at the same time preserving the amicable nature of MAP negotiations. NBDR could include processes, commonly used in commercial dispute resolution but needing to be adapted for use within MAP, such as:

- Good offices;

- Mediation;

- Conciliation;

- Expert evaluation;

- Expert determination;

- Arbitration (mandatory or voluntary); and

- The binding or non-binding nature of each such process.

The Subcommittee had an extensive discussion of the advantages and disadvantages of NBDR. A potential advantage of non-binding procedures (such as mediation or expert evaluation, or a combination of both) is that they could help balance the different experience levels between the parties to a MAP and facilitate an earlier amicable resolution of the procedure. In addition, an increasing number of countries, including developing countries, are looking for means of improving their tax treaty dispute resolution mechanisms and seeking guidance on the measures that could or should be envisaged in order to ensure a level playing field, to support the requisite capacity-building and further the effectiveness of the MAP. NBDR could fulfil these needs.

During preparation of the Report it became clear that there was no consensus among Subcommittee members regarding the terminology to be used for these and related matters.

C.4.4.1.26. The Report offered recommendations on how to take its work forward, including:

- Possible Updates to the UN Model Tax Convention and its Commentary;

- Possible Updates to the UN MAP Guide; and

- The possibility of preparing a UN Handbook on Dispute Avoidance and Resolution.

The Subcommittee on Dispute Resolution will continue to explore these matters.

C.4.4.2. Other Dispute Resolution Procedures

C.4.4.2.1. 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 at source the benefits of the treaty to which they are entitled, 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 OECD Transfer Pricing Guidelines. The application of multilateral guidance is generally preferable, where possible, for reasons of consistency. Treaty negotiators may also wish to address specific bilateral issues, or reconcile differing multilateral approaches, by providing bilateral procedural guidance where necessary.

Advance Pricing Agreements

C.4.4.2.2. Advance Pricing Agreement (APA) programmes may be a particularly effective tool for providing advance transfer pricing guidance to taxpayers and greater certainty to both tax administrations and taxpayers, both in a domestic and cross-border context. Bilateral or multilateral APA agreements are able to help taxpayers avoid double taxation in a more structured way. In many countries both the tax administration and taxpayers tend to have a strong preference for APAs over dispute resolution by way of litigation. Some of the most active advocates of APA programmes have been OECD Member States that generally favour taxation at source such as Australia, Canada, and the Republic of Korea. China began negotiating bilateral APAs several years ago and India ~~has~~ implemented an APA programme in July 2012.

C.4.4.2.3. APAs have been used in many cases to resolve disputes for past years as well (through so-called “roll-backs”), sometimes addressing a total of ten or more years at one time. Where coverage of past years is permitted, APAs can be a very effective use of resources, especially for large or complex cases. It is possible to limit APAs to future years only, but that may limit the tax administration's ability to fully leverage the resources it invests in concluding the APA.

C.4.4.2.4. 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. Furthermore, as the taxpayer provides extensive information in advance, the APA process is usually efficient in determining relevant facts. Perhaps for this reason many tax administrations have a general practice of suspending examination activity during APA discussions. Tax administrations may wish to clarify in their APA procedures that all information pertaining to the APA request should be shared simultaneously with both countries. Tax administrations have also found APAs to be useful tools for developing a deeper understanding of business operations, which can be used to inform their general guidance and examination processes.

Most tax administrations have found that APAs are more widely embraced if APA and examination functions are kept separate. Alternatively, they may 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.

C.4.4.2.5. Tax administrations with severe resource limitations may wish to weigh the advantages of APAs against other resource needs. 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 programme at that stage. Such countries may also be concerned that they will be at a disadvantage in negotiating APAs with MNEs or more experienced countries until they develop more experience, including experience with MAP cases. On the other hand, APAs can be useful on an interim basis as an efficient means of collecting tax in the short term, particularly in countries with a small number of large foreign investors. An APA can conserve resources but cannot replace the need for trained audit staff, so it can be beneficial for training to proceed in parallel while outside technical assistance and APA expertise is available.

C.4.4.2.6. Countries with little transfer pricing experience may initially prefer to limit the terms of their APAs so they can evaluate the experience more quickly and adjust their practices if desired. A term of perhaps three years could be applied, rather than the five years more commonly used by experienced countries. Alternatively, they may wish to negotiate a few APAs in a pilot programme before committing themselves to a generally available, permanent programme. Another possibility is that such countries may choose to negotiate 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.

Developing and operating an APA programme

C.4.4.2.7. It is important to establish an appropriate operational framework for an APA programme, to promote a consistent, principled approach and to ensure adequate review. Ideally, APA programmes should be established with a special unit comprised of trained staff designated for that function only. This would maximize the benefits of experience and promote an attitude of cooperation and transparency. If, due to resource limitations, APA programmes 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 way as a typical audit proceeding. Otherwise many of the benefits typically enjoyed by tax administrations in APA proceedings may be lost.

C.4.4.2.8. At the same time it is important to ensure that the APA programme 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 programme from being used primarily to challenge the position of an audit team for past years. This may be achieved by requiring that the APA applies primarily to future years rather than past years. Organizationally most tax administrations have tended to manage their APA programmes together with their MAP programmes 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 different cases within an industrial sector or by

comparing the approaches of various treaty partners to similar issues. It is also important to establish procedures to facilitate the sharing of such knowledge, to strengthen technical analysis and to provide consistent treatment.

C.4.4.2.9. 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" based on which the APA will be renegotiated if necessary. It is fair to expect a renegotiation of the APA 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.

C.4.4.2.10. A tax administration's resources are normally 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 small and medium-sized enterprises (SMEs). A 2011 OECD survey of OECD member and observer countries found that a number of countries have adopted simplified measures for SMEs, small transactions and/or low value-added services and that Canada, France, Germany, Netherlands and the United States have simplified APA procedures for SMEs.[14] These programmes generally require SME taxpayers to provide less information and may also lower the application fee, if there is one.

C.4.4.2.11. Some administrations charge taxpayers user fees for the conclusion of an APA, as a means of funding the programme. If reasonable in amount these fees 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. The Guide to the Mutual Agreement Procedure under Tax Treaties provides for more guidance on best practices in the structuring and operation of APA programmes, and was approved by the Committee in October 2012.[15] Tax administrations may also want to refer to the Manual on Effective Mutual Agreement Procedures,[16] the Guidelines for Conducting Advance Pricing Arrangements under the Mutual Agreement Procedure (MAP APAs) in the Annex to Chapter IV of the OECD Transfer Pricing Guidelines,[17] and to the work of the EU Joint Transfer Pricing Forum on dispute resolution and APAs.[18] Finally, some national tax administrations, including those of Canada, India,[19]

---

[14]OECD, "Multi-Country Analysis of Existing Transfer Pricing after Simplification Measures", 10 June 2011. Available from http://www.oecd.org/tax/transfer-pricing/48131481.pdf

[15]The Guide is available from http://www.un.org/esa/ffd/tax/gmap/Guide_MAP.pdf

[16]More information available from http://www.oecd.org/tax/dispute/manualoneffectivemutualagreementproceduresmemap.htm

[17]More information available from http://www.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations_20769717

[18]Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreement with the EU {SEC(2007) 246} is available from https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/sec(2007)246_en.pdf

Japan, the United Kingdom[20] and the United States[21] as well as the Pacific Association of Tax Administrators (PATA)[22] have published detailed internal APA procedures. These may also provide useful comparative information.

Joint Audits

C.4.4.2.12. Developing countries may also want to consider participating in joint audits. These are conducted by two or more tax administrations together to share information, save resources and minimize or expedite the resolution of controversies. For example, the United States and the United Kingdom concluded a joint audit of a taxpayer in 2011 that took only six months to complete and produced an Advance Pricing Agreement resolving the issues for five future years as well. 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. On the other hand, issues such as different languages, authority to access foreign taxpayer information and differing accounting years and audit cycles may need to be addressed.

C.4.4.3. Multilateral Agreements

Interpretive guidance

C.4.4.3.1. Multilateral agreements are important tools to avoid cross-border disputes on transfer pricing and the resulting risks of unrelieved double taxation.

C.4.4.3.2. As noted above many countries have historically relied primarily on the guidance provided by the OECD 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 extensively draw upon the provisions of the OECD Transfer Pricing Guidelines. These include, for example, China, Egypt, India, Malaysia and South Africa.

C.4.4.3.3. Although the provisions of Article 9 of the UN Model Convention are very similar to Article 9 of the OECD Model, the interpretation provided by the OECD 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 level. The Commentary to Article 9 of the UN Model also recommends the OECD Transfer Pricing Guidelines to countries generally, although the 2011 Commentary notes that "[t]he views expressed by the former Group of Experts have not yet been considered fully by the Committee of Experts, as indicated in the Records of its

---

[19]More information available from http://www.itatonline.org/info/index.php/cbdts-advance-pricing-agreement-guidance-with-faqs/

[20]More information available from https://www.gov.uk/hmrc-internal-manuals/international-manual/intm422010

[21]More information available from http://www.irs.gov/pub/irs-drop/rp-06-9.pdf

[22]More information available from http://www.irs.gov/pub/irs-utl/pata_bapa_guidance_-_final.pdf

annual sessions".[23] Therefore, developing countries may wish to consider the relevance of the OECD 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.

C.4.5. Coordination of Domestic and Cross-Border Dispute Resolution Procedures

C.4.5.1. Each country will have its own domestic dispute resolution procedures in addition to cross-border procedures. It is important that these be properly coordinated for two reasons.

C.4.5.1.1. 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. Most tax administrations prefer to deal with an issue either through MAP or through domestic procedures, but do not generally operate both procedures simultaneously (with the exception of certain simultaneous MAP and domestic appeals programmes).

C.4.5.1.2. Second, notwithstanding such resource concerns, it is important to manage any duplication issues without forcing taxpayers to make a premature choice between domestic and cross-border procedures. For example, taxpayers should not be required to give up 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 by placing them on hold (usually after filing an initial notice of objection) 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. Some tax administrations prefer instead to set a deadline for the filing of a MAP request.

C.4.5.1.3. Taxpayers should be permitted, however, to pursue MAP consideration of a relevant cross-border issue or issues while pursuing domestic dispute resolution procedures for separate issues that are not appropriate for MAP.

C.4.5.1.4. In some countries there is a view that the tax administration, including the Competent Authority, is bound by a final decision of a domestic court and that MAP consideration is not available in such circumstances. Some other countries view this as inconsistent with the obligations of the treaty MAP provisions. Where a Competent Authority takes the view that it cannot or should not depart from domestic court decisions it should clearly state this position in public guidance for the information of treaty partners and taxpayers.

C.4.5.1.5. The Competent Authority of one country is, of course, not obligated in any way to accept either a court decision or an administrative settlement of another country. Of course the Competent

[23] Please refer to the Commentary to Article 9, under A. General Considerations, 3. Available from http://www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf

Authority may choose to provide relief on a unilateral basis if it agrees with the result reached, but it should not be expected to provide relief solely because it is otherwise unavailable.