

7. Mandatory Dispute Settlement (MDS)

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7.1. Introduction

In chapter 5, the use of the Mutual Agreement Procedure (MAP) has been explored and chapter 6 examined the use of Non-Binding Dispute Resolution (NBDR) mechanisms in the context of MAP .

This chapter examines the concept of Mandatory Dispute Settlement (MDS) as a supplement to MAP. Today, there are only a relatively small number of countries that use this approach, but with the increased risk of cross-border disputes, as explained in Chapter 1, countries, both individually and collectively, are beginning to show more interest in this approach . This chapter

first explains how MDS works in practice, then examines the different positions that have been put forward and finally sets out some guidelines for countries that want to move in this direction.

7.2. Legal Basis

7.2.1. Concept of MDS to supplement MAP

Although MAP has generally been successful in resolving a majority of cases brought in countries with an active MAP program ¹, **some States have shown a preference towards supplementing MAP with mandatory dispute settlement (MDS) mechanisms such as ‘arbitration’.**

Countries that seek to supplement MAP with MDS may include an additional paragraph in the MAP article (generally Article 25) of their tax treaties that allow **MAP cases that have been unresolved for a certain period of time to mandatorily be submitted to one or more independent persons for a decision that will be binding for both States to follow.**²

While this option may be referred to as ‘expert determination’ or ‘arbitration’, international tax experts have been referring to this process as ‘tax treaty arbitration’ owing to familiarity and for ease of reference.

It is important to note that MDS in tax treaties is different from ‘arbitration’ in a legal and commercial sense. While commercial arbitration is an alternative dispute resolution mechanism through which disputes can independently be resolved by the parties involved, MDS in tax treaties is merely an extension of the MAP process and may be used only where a case is unresolved through MAP for a prescribed period of time (usually 2 or 3 years).

Further, unlike an arbitration award in commercial arbitration that requires enforcement through a Court system, **MDS results in a decision that is to be implemented by the competent authorities.** In fact, competent authorities may even be given the discretion to arrive at an agreement different from the decision resulting from the MDS.³

¹ See OECD, Map Statistics, 2016.

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

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

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

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

7.2.2. The UN Model Position

Article 25 of the UN Model Convention (2011) dealing with dispute resolution contains two ‘alternatives’. Alternative A provides only for MAP as described in Chapter 5 of this Handbook. **Alternative B, however, provides for MDS, termed ‘arbitration’. An additional paragraph 5 is included in Alternative B of Article 25 where issues that are unresolved through MAP may be submitted to ‘arbitration’.**

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

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

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

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

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

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

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

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

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

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

7.2.3. The OECD and MLI Positions

Article 25(5) of the OECD Model Convention (2017) is largely similar to Article 25(5) in Alternative B of Article 25 of the UN Model Convention.

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

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

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

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

for in the OECD Model Commentaries as well, a large part of which has been referred to in the UN Model Commentary on Article 25.

The treaty-based changes proposed by the BEPS project have been implemented through a multilateral instrument (MLI). The MLI is a multilateral treaty under public international law with its own direct effect, but it only stands to modify only the application of bilateral treaties between the parties to the MLI to the extent of the treaty changes proposed in the BEPS Project and to the extent as mutually agreed between the two parties to the treaty. Accordingly, the text of the MLI was adopted on 24-25 November 2016 and since the first signing ceremony on 7 June 2017, as of 1 August 2017, 70 jurisdictions have signed the MLI and have already begun the ratification process.

The MLI contains an option for mandatory binding arbitration in Part VI that 28 jurisdictions have signed up for as of April, 2018 and will remain optional for all MLI signatory jurisdictions to adopt. This provision is more detailed than the provisions in the Model Conventions since detailed rules have been added in the provision itself on access to arbitration, information requests and timelines, appointment of arbitrators and costs, mode of conduct of arbitration, independence, transparency and confidentiality rules. The MLI arbitration provision also allows for flexibility in approach i.e. choice between last best offeror independent opinion or other approach, open-ended reservations as regards the type of cases that each jurisdiction wants this procedure to apply to, options to substantively follow OECD or UN Model approach for arbitration (except for access directly to taxpayers) etc. Last best offer arbitration is sometimes referred to as ‘baseball’ arbitration as well. In this type of arbitration, both competent authorities are required to propose a solution to the issues and the arbitral panel is bound to choose one of the proposed resolutions. In independent opinion arbitration the arbitral panel is expected to consider the facts and evidence and review the legal positions before arriving at a reasoned decision.

7.2.4. Some jurisdictions that do not currently have bilateral tax treaty arbitration provisions in place have chosen to implement them through the MLI. EU and National Approaches

There are rules for arbitration in tax matters within the European Union. The EU Arbitration Convention⁹ provides for arbitration that is triggered if MAP is unsuccessful for 2 years, much like under the OECD Model Convention. The Convention contains more detailed

⁹ [To be filled]

procedural rules (as in the MLI) for selection of arbitrators and rules of evidence, including a list of independent persons who are suitable to act as arbitrators along with detailed procedural rules for their selection and the selection of the Chair of the arbitral panel. The Convention also makes the decision of the arbitral panel time-bound.

A new directive to govern cross-border dispute resolution through instruments such as the Arbitration Convention and tax treaties has also been passed in the EU in 2017.¹⁰ This Directive also contains procedural elements such as strict time-limits at every stage and access to domestic Courts for the taxpayer in case of inaction at any stage. Since the Directive may constitute supra-national law for member States of the EU, such States may include the same procedures for dispute resolution in their tax treaties as well to avoid conflicts.

Several country tax treaty models also prescribe arbitration provisions. The United States has entered into many tax treaties that prescribe “baseball arbitration” to supplement MAP. For example, the baseball arbitration provision in the US-Canada tax treaty has been seen as successful by both business and the States themselves. The most successful aspect of the provision has been to encourage the competent authorities to enter into a MAP agreement before arbitration is triggered. Accordingly, the US Model Convention (2016) has proposed to include a detailed arbitration provision that relies on ‘baseball arbitration’.

7.3. Different views of the appropriateness of MDS

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

7.3.1 The concerns

Several concerns raised primarily by developing countries during discussions at the Committee level have been recorded in the UN Model Commentaries.¹¹ These concerns include possible sovereignty and constitutionality concerns, costs and lack of resources, even-

¹⁰ [To be filled]

¹¹ Paragraph 4, UN Model Commentary on Article 25 (2011).

handedness in the process, lack of experience and familiarity with MAP and arbitration, transparency and reviewability and enforceability.¹²

These States are of the view that MDS in tax treaty disputes affects their sovereignty. Some States consider the inclusion of arbitration of a tax dispute ‘unconstitutional’. Some other States consider that the inclusion of arbitration, whilst constitutional, may create other constitutional obligations such as extension of such remedies in domestic cases. Other States that do not have the above concerns have raised the issue of shifting of decision making power from the State to an entity that they have no confidence in or experience with.

Some States have also raised concerns as regards costs. Arbitration necessarily entails costs in terms of fees for the arbitrators, facilities and additional fees for counsel/representation. Moreover, in terms of a developing country, these fees may be payable in a foreign currency on a scale that is not proportional to the resources available to them. Further, developing countries having limited experience in arbitration may also need to hire outside experts to familiarize their competent authority function with the process, which would increase the costs involved.

Several developing countries have also raised concerns as regards their perceived lack of experience in arbitration as compared to developed countries. This may make it difficult for such countries to present their case in the most efficient manner.

Some States believe that MDS may also lead to concerns of even-handedness. As of today, there is only a small pool of possible arbitrators around the world who can deal with complex international tax and transfer pricing issues and most of them come from the developed world. Although this group may include academics and people having no affiliation with Governments or business, these States claim that their thought process and understanding of international taxation may be tuned to the developed world and might not be familiar with concerns of developing countries.

Some States are of the view that tax treaty arbitration may also raise concerns of transparency, reviewability and enforceability. Arbitration proceedings are generally considered confidential and opinions are not published. Further, in mandatory binding

¹² UN Model Double Taxation Convention Article 25 Commentary Paragraph 4 and 5; UN, ‘Secretariat Paper on Alternative Dispute Resolution in Taxation’, E/C.18/2015/CRP.8, October 8, 2015, available at: http://www.un.org/esa/ffd/wp-content/uploads/2015/10/11STM_CRP8_DisputeResolution.pdf.

arbitration in tax treaties, opinions are considered binding on the competent authorities. In some States, inherent powers granted to Courts under constitutional law may allow review of such opinions, either before or after they are implemented through mutual agreement. Another concern raised by some States is as regards enforceability of arbitral awards without a specific mechanism such as what is found in commercial disputes or investment treaty disputes.

7.3.2 The perceived benefits

MDS may be considered appropriate by countries concerned that there is no assurance that MAP will be able to resolve all disputes and where there is a feeling that MAP not being time-bound has resulted in disputes not being resolved, or taking too long to resolve. The UN Model Commentaries, based on the discussions by the Committee, have noted some perceived benefits in relation to introduction of MDS to supplement MAP.¹³

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

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

States have also taken the view that MDS to supplement MAP may provide more certainty to taxpayers. Since MAP may not guarantee a resolution, supplementing MDS with MAP may increase the certainty that a taxpayer feels as regards conclusion of the MAP and eventual resolution of double taxation or taxation not in accordance with the treaty. These states also believe that this will boost cross-border investment.

¹³ Paragraph 5, UN Model Commentary on Article 25 (2011).

Some States have taken the view that legal and constitutional concerns should not arise in MDS since sovereignty is legally ceded to the extent of the tax treaty and the dispute resolution mechanism in a treaty merely enforces such provisions. Some other States also rely on their experience with arbitration and mandatory dispute settlement in treaties in other areas such as trade and investment to cite that sovereignty concerns do not arise. Further, they claim that impartial decisions by arbitrators from all backgrounds, including from developing countries, may help overcome lack of experience of developing countries. Finally, such States also believe that the costs arising may not be too high owing to the limited number of cases that may go to arbitration, the ability to structure an efficient arbitration process and to put a cap on the compensation of arbitrators.¹⁴

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

7.4. Procedural Guidelines for the implementation of MDS by opting countries

7.4.1. General Overview

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

7.4.2. Initiation of MDS proceedings

¹⁴ The experience of the EU Arbitration Convention where very few cases have been submitted to arbitration has been cited in this regard. *See Ibid.* [CD: But aren't there a great many cases still pending in MAP under that Convention? A better example might be the US-Canada treaty, where fewer than 10 cases have been arbitrated over more than 8 years, while hundreds of MAP cases have been successfully resolved. The fact that Canada is (I believe) the only OECD member country thus far found in the BEPS MAP Peer Review to have an average case resolution time within the 24-month target timeframe can no doubt be attributed in great part to the fact that most of its MAP cases are with the US and thus benefit from the tax treaty arbitration provision.]

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

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

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

Where the taxpayer is allowed to file the request, it should be allowed to do so to either competent authority. This is in line with the provision in the BEPS Action 14 Final Report that allows a MAP request to be filed before either competent authority and as reproduced for arbitration in the Sample Mutual Agreement provided in the 2017 OECD Model Commentaries. However, it may be noted that since this option has not yet been accepted even for MAP in all bilateral treaties or adopted in the UN Model Convention, a State that allows the taxpayer to file an MDS request, may take the view that it is acceptable, in the absence of a contrary treaty requirement, to require the request to be filed with the competent authority of the taxpayer's residence State. In such cases, this requirement should be clearly stated in the applicable treaty.

If information required by either competent authority pursuant to its published MAP procedures has not been provided by the taxpayer in a timely manner the period before which the case is eligible for arbitration may be extended. The MLI and the 2017 OECD

Model Commentaries allow for extension of the time-periods involved in such cases. States may either refer to domestic guidance for information required to be provided in a MAP case or set out an exhaustive list in the competent authority agreement.

Information that States may wish to consider requiring as relevant for a MAP proceeding is provided in the box below:

BOX 1:

- 1) The name, address and any taxpayer identification number of the taxpayer;
- 2) The name, address and any taxpayer identification number of the related foreign taxpayer(s) involved (for transfer pricing cases);
- 3) The foreign tax administration involved and, if relevant, the regional or local tax administration office that has made, or is proposing to make, the adjustment(s);
- 4) The tax treaty article that the taxpayer asserts is not being correctly applied, and the taxpayer's explanation of how it believes the article should be interpreted and/or applied;
- 5) The taxation years or periods involved;
- 6) A summary of the facts, including the structure, terms, and timing of all relevant transactions and the relationships between related parties (the taxpayer should advise the competent authority of how the facts may have changed during or after the relevant taxable period, and of any additional facts that come to light after the submission of the MAP request);
- 7) An analysis of the issues for which competent authority assistance is requested and the relevant legal rules, guidelines or other authorities (including any authorities that may be contrary to the conclusions of the taxpayer's analysis). The analysis should address all specific issues raised by either tax administration as well as the amounts related to the adjustment(s) (in both currencies and supported by calculations, if applicable);
- 8) For transfer pricing cases, any documentation required to be prepared under the domestic legislation of the taxpayer's State of residence (where the volume of a taxpayer's transfer pricing documentation is large, a competent authority may determine that a description or summary of the relevant documentation is acceptable) and a detailed description of the companies involved, including an analysis of their functions and risks, to the extent relevant;
- 9) A copy of any other relevant MAP request between the same countries for the same issue, but for different years and the associated documents filed, or to be filed, with the competent authority of the other Contracting State, including copies of correspondence from the other tax administration, copies of briefs, objections, etc., submitted in response to the action or proposed action of the tax administration of the other Contracting State (translations of relevant documents may be helpful, and, where documentation is voluminous, a competent authority may determine that a description or summary of such documentation may be acceptable);
- 10) A statement indicating whether the taxpayer or a predecessor has made a prior request to the competent authority of either Contracting State with respect to the same or a related issue or issues;
- 11) A schedule of the relevant time limits and statutes of limitation in each jurisdiction (whether imposed by domestic law or the tax treaty) with respect to the taxable periods for which MAP relief is sought (in cases of multiple taxpayers, a schedule for each taxpayer);
- 12) A statement indicating whether the taxpayer has filed a notice of objection, notice of appeal, refund claim, or any other comparable document in either of the relevant jurisdictions;

- 13) A statement indicating whether the taxpayer's request for MAP assistance involves issues that are currently or were previously considered by the tax authorities of either Contracting State as part of an advance pricing arrangement, ruling, or similar proceedings;
- 14) A copy of any settlement or agreement reached with the other jurisdiction that may affect the MAP process (with a translation, if applicable);
- 15) If the taxpayer has not already provided consent for a person to act as its authorized representative, a signed statement that a representative is authorized to act for the taxpayer in all matters connected with the MAP request.
- 16) The taxpayer's view on any possible basis on which to resolve the issues;
- 17) Any other facts that the taxpayer may consider relevant.

(reproduced from UN GMAP para 94)

7.4.3. Terms of Reference

“Terms of Reference” refers to the questions that must be decided by the MDS Panel.

Although the ‘arbitration’ provisions in the Model Conventions are silent as regards “Terms of Reference”, it may be important to refer to them in a competent authority agreement. Following the Sample Mutual Agreement in the UN Model Commentaries, within three months from receipt of the arbitration request by the second competent authority (as determined by agreement), the competent authorities may decide the “Terms of Reference”. This time period is reduced to 60 days in the OECD Model Commentaries.

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

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

Separate rules may be laid out for failure to communicate the terms of reference as well.

If the Terms of Reference have not been agreed by the competent authorities and communicated to the person who has presented the case within three months, the competent authority agreement may allow each competent authority to, within one month after the end of the three month period, communicate in writing to each other a list of issues to be resolved by the arbitration, which may then constitute the tentative Terms of Reference. Within one month after all the arbitrators have been appointed, the arbitrators may then communicate to the competent

authorities and the person who presented the case a revised version of the tentative Terms of Reference, which shall become final. Within another one month period, the competent authorities may also be provided the possibility to agree on different Terms of Reference and to communicate them in writing to the arbitrators and the person who presented the case, which shall become final.

7.4.4. Selection of the MDS Panel

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

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

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

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

States are free to depart from these rules to create customized MDS Panels. For instance, a single arbitrator or a five member panel may also be prescribed. However, States are urged to use an odd number of members in the MDS Panel to avoid having a tie of votes.

States may also consider specific or regional approaches while devising such rules. The approach adopted in the EU Arbitration Convention and Directive involving maintenance of a panel of ‘independent’ persons¹⁵ and detailed rules regarding selection of the Chair may be noted. States may also develop a new approach based on their policy goals. For example, the Austria-Germany tax treaty has prescribed the European Court of Justice as the arbitrator for supplementary arbitration where MAP is unsuccessful.¹⁶

States may, accordingly, agree on a panel of arbitrators from which arbitrators may be chosen for each dispute arising out of their tax treaty.

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

Each arbitrator must be qualified to serve in such position. The MDS provision or agreement may stipulate that arbitrators should be persons with recognized competence in the fields of international tax law who may be relied upon to exercise independent judgment in the area of tax treaty disputes.¹⁷ States may also consider selecting multiple potential arbitrators and agreeing on a list of arbitrators that may be called upon in respect of each treaty.

Each arbitrator must be independent. The sample mutual agreement in the UN Model Commentaries suggests that any person including government officials of either State involved may be an arbitrator unless they were themselves involved in the particular case beforehand. The OECD Model Commentaries provide for the same. However, the UN Model Commentaries

¹⁵ Paragraph 15 of the Annex to the UN Model Commentary on Article 25 also considers the creation of a list of suitable persons for arbitration by the UN Committee of Experts on International Co-operation in Tax Matters.

¹⁶ On September 12, 2017, the Court delivered its first arbitral opinion under this provision in *Republic of Austria v Federal Republic of Germany* (Case C-648/15).

¹⁷ Adapted from Section 14(1), ICSID.

also suggest that the arbitrator provide a written statement (or an affidavit) that states his impartiality or neutrality, which is not provided for in the OECD Model Commentaries.

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

States may consider these options and agree on independence and transparency rules as regards the arbitrators. However, it may be in the interest of States also to require a written declaration as suggested in the UN Model Commentaries to ensure neutrality and independence.¹⁸ States may consider using the following format for the declaration:

BOX 2: Declaration by Arbitrator:

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

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

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

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

All official communications amongst the Panel and between the Panel and competent authorities and/or the taxpayer should ensure confidentiality. If the necessary encryption is

¹⁸ This mechanism is also used in ICSID as regards arbitrator independence.

not possible in the e-mail accounts of all parties involved, an encrypted cloud server should be used for all communications and sharing of documents. Till the Chairman is appointed, communications may be required to go to all arbitrators and once the Chairman is appointed, the Chairman may be required to lead all communications.

7.4.5. The MDS Process

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

The ‘sample’ mutual agreement in both the UN and OECD Model Commentaries endorses the use of the ‘last best offer’ or ‘baseball’ arbitration approach. Within 2 months from the appointment of all arbitrators, each competent authority should present its proposed resolution and a decision shall be delivered by the panel within 3 months from thereon.¹⁹ However, it may be noted that until the 2017 update, the default option in the OECD Model Commentaries was the ‘independent opinion approach’.

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

Specific rules may be required as regards the ‘last best offer’ approach. The proposed resolution should ideally be limited to a disposition of specific monetary amounts or the maximum tax rate applicable, depending on the transaction. Where substantive issues are pending as well (for example, whether a permanent establishment exists), the competent authorities may give alternative proposed resolutions for either result. Competent authorities may also provide supporting position papers to which replies may be provided by the other competent authority. However, page limits may be set for the proposed resolutions, position papers and replies to ensure that this method works in an efficient and time-sensitive manner.²⁰

¹⁹ Annex, UN Model Commentary on Article 25 (2011).

²⁰ Rule 9, Memorandum of Understanding Between The Competent Authorities of Canada and The United States of America.

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

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

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

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

Neither the OECD nor the UN Model Convention prescribes a specific timeline within which the arbitration process should be completed. However, the sample mutual agreements provide for timelines. The UN sample mutual agreement provides that the decision should be communicated to both competent authorities within three months from having received the last reply from the competent authorities under the baseball approach. Under the alternative independent opinion approach, the UN sample mutual agreement provides that the decision should be communicated within six months from the date on which the Chair notifies that necessary information has been received.²¹ However, the OECD sample mutual agreement

²¹ Para 11 of the UN Sample Mutual Agreement also provides that: “If within two months from the date on which the last arbitrator was appointed, the Chair, with the consent of one of the competent authorities, notifies in writing the other competent authority and the person who presented the case that he has not received all the information necessary to begin consideration of the case, then

provides that the decision should be communicated to both competent authorities within 60 days after the reception by the arbitrators of the last reply submission or, if no reply submission has been submitted, within 150 days after the appointment of the Chair of the arbitration panel (under the baseball approach) and within 365 days from the appointment of the Chair (under the independent opinion approach), Countries should keep timelines in mind if they are looking at MDS that supplements MAP to be a ‘speedy’ solution.

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

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

Further, the sample mutual agreements in both the UN and the OECD Model Commentaries suggest that the competent authority to which the case giving rise to the arbitration was initially presented should be responsible for the logistical arrangements for the meetings of the arbitral panel and will provide the administrative personnel necessary for the conduct of the arbitration process. However, if one country disproportionately raises more adjustments than the other country (typically the source country will raise more adjustments), countries may consider adopting a rule to provide for alternating the responsibility for the logistical arrangements.

Neither the UN Model Convention nor the OECD Model Convention specifically allows for taxpayer participation in the arbitration process. While the sample mutual agreement in the OECD Model Commentaries allows participation by the person requesting the arbitration

-- if the Chair receives the necessary information within two months after the date on which that notice was sent, the arbitration decision must be communicated to the competent authorities and the person who presented the case within six months from the date on which the information was received by the Chair, and

-- if the Chair has not received the necessary information within two months after the date on which that notice was sent, the arbitration decision must, unless the competent authorities agree otherwise, be reached without taking into account that information even if the Chair receives it later and the decision must be communicated to the competent authorities and the person who presented the case within eight months from the date on which the notice was sent.”

process in writing to the extent allowed in MAP and orally if allowed by the panel, the UN Model Commentaries do not provide for this since arbitration may only be requested by the competent authorities in the UN Model Convention provision. The MLI, however, does not provide for taxpayer participation.

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

7.4.6. Confidentiality

Since arbitration proceedings involve third parties receiving information, it is important to ensure the confidentiality of taxpayer information and the impartiality and independence of the procedure. The sample mutual agreements in both the UN and the OECD Model Commentaries provide that both States should agree that arbitrators appointed would be deemed to be authorized representatives of the appointing parties as regards communications and the confidentiality of information provided. The MLI adds another layer of protection by not just prescribing arbitrators as authorized representatives, but 3 staff members per arbitrator as well and also requires a written statement as regards confidentiality and non-disclosure obligations from each arbitrator and designated staff member.

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

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

7.4.7. Remuneration of arbitrators and costs involved

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

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

- Each competent authority bears all costs, including travel costs, related to its own participation and in relation to the arbitrator appointed by it or on its behalf by someone else.
- Costs related to the meetings of the panel and the personnel necessary for the process will be borne by the competent authority to which the case giving rise to the arbitration was initially presented.²²
- All costs in relation to other arbitrators and all other costs will be borne equally by the two States.

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

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

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

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

7.4.8. The Decision

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

States should clarify the criteria that the Panel must apply to arrive at a decision. The Panel should decide the issues submitted to arbitration in accordance with the applicable provisions of the tax treaty, and applicable domestic laws of the States involved. States may also allow the Panel to consider any other sources which the competent authorities of the

²² If presented in both States, the costs will be shared equally.

Contracting Jurisdictions may by mutual agreement expressly identify, or which may be identified by the applicable treaty or accompanying bilateral agreements.

States should clarify whether arbitral decisions should be published or not. The sample mutual agreements in the UN Model Commentaries do not, by default, refer to the possibility of publication of decisions made through arbitration since the UN Model Convention follows the ‘baseball’ approach. However, it follows the approach adopted in the OECD Model Commentaries if the ‘independent opinion’ approach is chosen. The sample mutual agreement in the OECD Model Convention allows publication if agreed to by the person making the request and both competent authorities with redacted details on the understanding that these decisions would carry no precedential value. A similar approach for redacted publication is allowed under the EU directive as well, however, without the requirement for permission of the parties involved. However, the MLI does not specifically allow the publication of decisions even in the ‘independent opinion’ approach.

States should also clarify whether decisions made by the Panel would have precedential value. This is not advocated by the OECD or the UN Model Commentaries or the MLI.

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

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

7.5. Capacity building for MDS

States should be equipped with a good knowledge of the MAP²³ and the arbitration process. This will enable States to prepare and present a good MAP and arbitration case. States will be better able to ensure that their positions are well articulated to be put up for consideration through the arbitral process.

²³ para 5.4.1 of the chapter on Tax Treaty Mechanisms to resolve cross border tax disputes: The Mutual Agreement Procedure.(suggest to edit as relevant. I have assumed that what would be covered in this paragraph would be what we are looking for in this section.)

Arbitrators for tax treaty arbitration may be equipped with the knowledge to solve complex international tax and transfer pricing issues. That said, for an arbitral process to be carried out efficiently and effectively, there is also a need for them to be trained in the procedural aspects of the arbitration process e.g. procedural and evidentiary rules, sharing of information and confidentiality rules, independence and transparency.

As of today, it is generally recognized that the small pool of possible arbitrators who can deal with complex international tax and transfer pricing issues come from the developed world. States may consider developing a pool of possible arbitrators from the developing world. This can be done by identifying gaps in the pool of relevant tax experts likely to be chosen as arbitrators and seeking to encourage more diversity of potential arbitrators in terms of region, gender and age. There will then be a more balanced pool of possible arbitrators who have a better understanding of the views and concerns of both the developed and developing world. Consequently, the outcome of an arbitral proceeding would also be perceived to be more balanced towards the needs of both parties to the proceeding.

7.6. The use of technology in MDS

Technology allows for cost-effective cooperation and communication between the competent authorities and/or the arbitrators. States are encouraged to use technology in MDS as much as possible as regards communications, meetings with arbitrators and transfer of documentation to avoid unnecessary costs. States may refer to [Chapter 5.x](#) of this Handbook for concrete suggestions on how technology may be used for reducing costs involved.

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

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

Advanced technology could also aide the MDS process. Modern technologies such as those involving artificial intelligence, blockchain etc. may also allow for procedural matters in an

MDS process detailed in Chapter 7.4 above to be done digitally. Further, the MDS decision process may also be made digitally, particularly in baseball arbitration where the arbitrators have to choose one solution as opposed to another.

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7.7. Case study in MDS

[To be reviewed, updated]

IMPORT CO. commissioned a transfer pricing study that established an arm's length range of €50 to €60 per tonne for its related party commodity transactions with its subsidiary SUPPLY CO., based upon long-term bulk contracts for the same commodity. IMPORT CO., located in Country E, imports this commodity in bulk from its subsidiary SUPPLY CO. in Country S.

In Year 1, IMPORT CO. paid SUPPLY CO. €52 per tonne for the commodity. However, Country S has upwardly adjusted SUPPLY CO.'s income, and assessed additional tax in Country S, based upon a price of €85 per tonne observed in some spot contracts for similar quantities of the same commodity in Year 1.

Upon review of a MAP request to both Countries E & S, Country E's Competent Authority believes that the correct price is €50 per tonne for Year 1 based on its review of the SUPPLY CO.'s third party contracts and similar arrangements (similar terms and conditions regarding geographical delivery, [level of the market?], timing, as well as pricing benchmarks and discounts) observed in the market. In Country E's view, the spot contracts used by Country S in its audit of SUPPLY CO. to benchmark the commodity price are demonstrably not comparable to the transactions in dispute and that at the limit, the pricing of this commodity could not be beyond the upper bound of €60 per tonne found in the original transfer pricing study. Therefore, Country E's Competent Authority supports SUPPLY CO.'s original pricing of €52 and believes Country S's Competent Authority should completely vacate the assessment of additional tax.

Meanwhile, Country S's Competent Authority believes the spot contacts are comparable in Country S due to specific market conditions and have used similar contracts to support adjustments/assessments of tax to other industry participants in Country S. While the Competent Authorities of Country E and Country S endeavour to resolve the dispute, neither is willing in their bi-lateral negotiations to compromise sufficiently on their respective positions such that a mutual agreement can be reached. The case is therefore tabled for arbitration.

Under the "independent opinion" approach, if the members of the arbitration panel are searching for a satisfactory solution, they may give credence to both positions and attempt to arrive at a price somewhere midway between the positions of Country E and Country S. If Country S tax authority's position is an extreme position that is above the normal pricing bounds of this commodity, then the "independent position" approach to arbitration, where the arbitration panel is seeking to appease both countries, may unfairly favour Country S. Recognizing this dynamic, both countries have an incentive, unseemly as it may be, to stake out a supportable position at the extreme pricing boundaries for this commodity to reach a result closer to its objective.

The last best offer or "baseball" approach tends to reduce various ploys or tactics noted above and incentivises the two Competent Authorities to advance more reasonable positions, which increases the likelihood that they will be able to reach a mutual agreement before an arbitration process begins. One may assume that if Country E and Country S submitted their positions above, €52 and €85 per tonne respectively, as their last best offer under a "baseball" style arbitration process, then based upon the limited facts presented, Country E's position of €52 may be the preferred choice of the arbitration panel. However, a more likely scenario is where Country E and Country S would probably not risk holding their initial positions throughout the MAP and "baseball" arbitration process if they see opportunities to concede and settle the case, which is the primary objective of a supplementary, last best offer or "baseball" style arbitration – encourage and incentivise settlements under the normal dispute resolution process.