Discussion Draft on

Chapter 6: Non-Binding Dispute Resolution (NBDR) Mechanisms

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*[**Note:** for Subcommittee Review: There are several issues noted below which we believe are best addressed in other chapters; we note them here for discussion during our NYC meeting]*

6.1. Introduction

In recent years, tax administrations around the globe have become more active in challenging tax planning strategies of MNEs, which has led to an increase in disputes.[1] With implementation of Country-by-Country reporting in a wide range of countries, as well as mandatory sharing of rulings and the many other actions that are currently contemplated or about to be initiated pursuant to various international projects (BEPS and unilateral actions by specific countries), it is likely that the range and intensity of cross-border tax disputes will further increase.

[1] See ¶ 1.5 and Appendix II.

The traditional means of resolving these disputes include negotiation via a treaty-based MAP procedure.[2] While MAP is widely viewed as a useful tool, it is essentially non-existent in many countries and/or partly inefficient due to lack of capacity or domestic law support, inability of administrations to always reach mutual agreements, or otherwise.[3] In view of this it seems important to provide sufficient assistance in capacity building and training to countries less experienced so that they feel more comfortable in engaging in the MAP procedure. If such processes are not successful or cannot be implemented, "unilateral" means of dispute resolution at the domestic level are the only means of addressing the dispute.[4] However, trying to resolve a dispute at the domestic instead of at the inter-State level may not resolve double taxation, due to a lack of effective coordination between the taxing jurisdictions.

Following recent amendments to both the UN Model (2011) and the OECD Model (2017), countries, especially those with long experience with MAP, have undertaken to resolve "stalled" MAP cases through mandatory dispute settlement ("MDS") by way of arbitration.[5] Formally, these arbitration procedures are embedded into the MAP process as a "tie-breaker" and only take place in cases in which negotiations between Competent Authorities ("CA") have been unsuccessful for a two or three year period.

Some countries, including countries which put into question the appropriateness of MDS for resolving tax disputes in their respective context, may wish to explore whether expert evaluation, mediation and other forms of Non-Binding Dispute Resolution ("NBDR") could become an alternative, or a precursory step, to MDS.

All forms of NBDR discussed in this chapter have as a common feature full respect for the sovereignty of the parties to a MAP proceeding and do not involve any prior commitment to a binding resolution of the matter in controversy. In entering an agreement for NBDR, the parties may commit to use of a NBDR tool in the MAP process and, if they agree on a resolution, to draft a CA agreement as would be the case in any mutually agreed MAP resolution.

The UN Model Treaty Commentary to Article 25 recognizes the potential benefits of consultation with outside experts:

> 41. It is recognized that, for some countries, the process of agreement might well be facilitated if competent authorities, when faced with an extremely difficult case or an impasse, could call, either informally or formally, upon outside experts to give an advisory opinion or otherwise assist in the resolution of the matter. Such experts could be persons currently or previously associated with other tax administrations and possessing the requisite experience in this field. In essence, it would largely be the personal experience of these experts that would be significant. This resort to outside assistance could be useful even where the competent authorities are not operating under the standard of an "agreement to agree", since the outside assistance, by providing a fresh point of view, may help to resolve an impasse.

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[2] See Chapter 5.
[3] See ¶ 1.5.
[4] See Chapter 3.
[5] See Chapter 8.

In 2017, the Commentary was expanded to recognize the potential benefits of NBDR:

> 41.1 The possibility for such assistance may include the utilization of non-binding methods of dispute resolution, such as mediation. For countries that wish to use such procedures, there are several non-binding methods that can be used to resolve disputes between parties at an early or later stage of the competent authority process. Such non-binding means of dispute resolution could range from facilitating the relational aspects of the competent authority process to providing insights or views on the substantive tax matters at hand in the dispute. Such methods are presently used for the resolution of tax disputes under the domestic laws of a number of countries. These procedures should, however, be utilized with due regard to issues such as the timing and duration of the procedures, the mechanism and criteria for selection of the mediator or other such appointed person and, the treatment of confidential information.

The OECD Commentaries on Article 25 also recognize the possible use of such procedures within the MAP procedure.[6]

In broad terms, disputes can be resolved by agreement of the parties themselves or by submitting the dispute to an independent third person who decides the dispute for the parties. In either situation, the binding nature is derived from a sovereign decision of the parties. In the former situation, the parties must agree with the individual case outcome; whereas in the latter, the parties give their consent to accept the outcome before they actually know the content of the decision.

Dispute resolution by agreement can also occur with the help of a third person who facilitates agreement but does not decide the case for the parties. These forms of dispute resolution can be called "non-binding" because, in the absence of an agreement between the parties, the intervention of the third person does not entail a binding outcome.

In non-tax international treaties and commercial contracts alike, non-binding and binding forms of dispute resolution are frequently combined in a multi-tiered process. A widespread form of multi-tiered dispute resolution is to: (i) give the parties a certain timeframe for reaching agreement through negotiation; (ii) then obtain input of an expert and/or mediator; and (iii) finally, if these "non-binding" attempts are not successful within the fixed timeframe, the dispute can (or must) be escalated to binding dispute settlement (e.g. arbitration). The underlying objectives of such a multi-tiered process are that

(a) The dispute should be resolved ideally by negotiation using the minimum third party intervention necessary;

(b) Accordingly the formality, cost, and time commitment required from the parties and the level of third party intervention increases from tier to tier; and

(c) The final tier provides for a final and binding decision (such as an arbitral decision).[7]

[6] OECD Model Commentaries on Article 25 ¶¶ 86 - 87.
[7] See ¶ 6.7

NBDR has been used by a number of tax administrations, with varying degrees of success, to facilitate the resolution of domestic tax disputes. The evolution of such techniques for use in the unique circumstance of treaty-based MAP could be useful. The purpose of this chapter is to provide guidance on forms of NBDR that could be adapted for resolving MAP cases.

While many forms of NBDR exist in the commercial world, this chapter focusses on elements of such procedures that are believed to be appropriately utilized in the specific MAP context – expert advice and mediation. For appropriate use in the CA process, such procedures need to be adapted to the specific needs of the parties. As so adapted, the procedures may differ in material respects from procedures used in commercial contexts.

Expert advice is a NBDR mechanism that consists of a technical expert reviewing evidence presented by the parties (or a party unilaterally). This procedure could involve an independent third party acting as an expert and rendering advice. In such a procedure, the inputs of the expert would be advisory in nature.

Mediation is a form of process-related assistance that involves the use of a mediator or facilitator to aid in providing a perspective on the discussions, identify issues that prevent resolution of a conflict, and bringing a problem-solving focus to the negotiating table.[8] The degree of activity of the mediator can range from a rather passive to a more active role, depending on the needs of the parties and the nature of the dispute. As with expert advice, inputs of a mediator would be advisory in nature.

Additional details of the procedures will be set forth below.

6.1.1. Potential Advantages/Disadvantages of NBDR Processes in MAPs.

Advantages:

- Establish a process to develop expertise, and confidence in international tax dispute resolution under the UN Model in a manner consistent with each country's comfort level and allow the CAs to maintain control of the case resolution. Exploit the confidence generated in several countries at the domestic tax dispute level with respect to NBDR *[***Note:*** Is this type of comment best addressed in Chapter 3 on domestic processes, with a cross-reference here?].*

- May help clarify complicated issues between tax authorities and allow them to reach a MAP agreement, increasing the efficiency of the MAP process.

- Could be more efficient than a binding dispute resolution process as it may require fewer resources and lead to a higher satisfaction of the parties.

- Could provide incentive for the parties to reach mutual agreement on their own.

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[8] In commercial contexts, other forms of NBDR are often utilized – e.g., "conciliation" is a slightly more formal means of an, in essence, mediation process. As used in this chapter, "mediation" includes all elements of such procedures as are appropriate in the MAP process.

- Provide a means of “leveling the playing field” where the experience of CAs is unequal.

Disadvantages

- NBDR is not binding so there there is no guarantee that the case will be resolved.
- If no agreement is found in the NBDR process, the dispute remains unresolved. In that latter sense, NBDR is less efficient and effective than binding dispute resolution.
- Investment of time and expense in developing such NBDR processes.

6.2 Practical Implementation and Framework.

Decades of experience with such NBDR processes in non-tax contexts counsels that a variety of practical elements will need to be addressed in designing and implementing such processes for use in disputes in the international tax treaty context. The following case study is used to provide context to address such elements:

<u>BusCo Case Study</u>

BusCo is a large multinational, integrated enterprise which designs/develops, manufactures, and distributes buses globally, headquartered in Country A with manufacturing and distribution operations throughout the world. In County B, wholly-owned subsidiary LocalCo has two assembly plants, producing different models, and a sales/distribution organization working through an independent dealer network.

The cross-border flow of goods and services historically included vehicles, management fees, and royalties for trademarks and technology under a licensing arrangement between BusCo and LocalCo with LocalCo characterized as an “at risk” entrepreneur paying royalties and services fees (excluding stewardship costs). BusCo sold buses at a fully-loaded cost plus 7%, which provided stable returns to its manufacturing function. LocalCo resold to independent customers based on local market conditions for specific models. LocalCo profitability varied over the years depending on demand for the two models it assembled and demand for the BusCo models. LocalCo developed its own warranty program hoping to stabilize and expand its sales base.

After a downturn in the global economy and mounting losses for both BusCo and LocalCo, the parent restructured its supply chain by closing one of the LocalCo assembly plants and converting LocalCo into a limited risk distributor and assembler of buses. The licensing agreement was terminated, the remaining assembly function of LocalCo was compensated on a Return on Value Added Costs (“ROVAC”), and the distribution function on a return on its sales, general and administrative (SG&A) costs (a so-called Berry Ratio method). In Years 1, 2, and 3 after the restructuring, LocalCo became profitable with thin margins sheltered by loss carryforwards (including plant closure costs).

Country B tax authorities challenged the restructuring with an assessment based on a determination that: (i) the licensing agreement and LocalCo’s entrepreneur status were terminated early without compensation; (ii) LocalCo should have earned the profit that

would have occurred if there had been no restructuring; and (iii) an alternative position asserting a capital gain on the disposition of the LocalCo business. In the absence of a successful MAP process, LocalCo and BusCo will incur double taxation,

Accordingly, BusCo and LocalCo sought MAP relief under the Country A – Country B Tax Convention on the basis that there was taxation not in accordance with the Convention. In discussions with the Country B tax authority, LocalCo was advised that the authority had limited experience in either MAP proceedings. Similarly, the Country A authorities advised BusCo to be patient with the process due to the lack of experience of Country B.

After three years in a MAP process, BusCo and LocalCo were frustrated with the lack of progress. Seeing no likelihood of successful resolution, the CAs agreed to undertake some type of NBDR process to facilitate a mutually acceptable resolution of the prior year assessment.

The inability to achieve closure of MAP cases in the situation of the BusCo Case Study is a reality faced by many countries and MNEs. The inquiry of BusCo and LocalCo about potential alternative processes is understandable. In the event that either, or both, of Country A and Country B are open to considering such procedures, there will be a variety of practical considerations to be addressed.

6.2.1. NBDR Framework.

An initial consideration will be whether the countries in question require a separate domestic legal framework to be able to have NBDR as possibility within a MAP. As noted in the Introduction, Article 25 in both the UN and OECD Model Treaties allow for NBDR as part of the MAP process. It is another question, however, whether the domestic law of a particular country might require a separate legal framework.This is a matter that needs to be evaluated on a country specific basis. In many countries, the legal basis for entering bilateral tax treaties provides sufficient authority for the CAs to adopt administrative guidelines, including with respect confidentiality, NBDR, and other matters. [9] In other countries, it may be that specific legislation could be necessary to enable the CA to agree to use of NBDR as an element of the MAP process.

A further consideration is whether countries should memorialize the terms of utilization of NBDR for MAP proceedings on a case-by-case specific basis or adopt a general framework for their relationship:

- A case-by-case basis would be facilitated by concluding a procedural CA agreement ("CAA") for individual cases.

- A general framework could apply to multiple cases, which could also be set out in a CAA.

    - A general framework offers the advantage of an economy of scale (in the sense of no need to renegotiate over and over again the same rules) and procedural

[9] Maintenance of sovereignty is, understandably, often a critical element of the dispute resolution process for many countries. It is unlikely that a country which has committed to MAP has a serious domestic law issue with NBDR since the contemplated processes are not binding. As a rule, if a tax authority has the capacity to enter into an agreement regarding a dispute, it also has authority to commit to a process whose outcome is not binding upon it without its consent. There is extensive practical and legal experience in non-tax areas in most countries that can be consulted for guidance on such issues.

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efficiency. On the other hand, a disadvantage could be inflexibility, especially if the rules cannot be amended.

- It would also be possible to achieve a mixture by agreeing on a general framework with a set of default rules, allowing the countries to negotiate specific terms applicable to a specific case (such as for the specific areas of disagreement in the BusCo Case Study)

6.2.2 Issues to be Addressed in a CAA.

The issues that could be addressed in a CAA authorizing the parties to utilize NBDR as an element of their process, always retaining complete decision-making authority, could include the following:

- Nature of the procedure: expert advice or mediation, or the option to combine both (as discussed below).
- Timing of NBDR within the timeframes of MAP.
- Is utilization of NBDR procedure optional or mandatory?
- Manner of determination of the issues to be discussed (e.g., through so-called "Terms of Reference" to be agreed at the outset of the NBDR procedure).
- Mandatory or optional stages of the procedure (e.g., determination of Terms of Reference, procedural discussions, written submissions, oral discussions, possibility of non-binding recommendations).
- Interaction with other procedures, notably domestic administrative or court proceedings and tax treaty arbitration (if available) -- e.g., is mediation a precursor to arbitration?
- Default timelines.
- Means of selection of the expert or mediator ("Neutral Third").
- Role, function and attributions of the Neutral Third.
- Interplay between more than one Neutral Third (e.g., mediator + expert).
- Eligibility, qualifications, conflicts of interest (and disclosure thereof), vetting, and appointment of Neutral Third.
- Impartiality obligations and rules on the safeguarding of independence of the Neutral Third.
- Confidentiality obligations of the Neutral Third and regime applicable to disclosed information (e.g., is the Neutral Third considered to be part of each CA for domestic law purposes? How can sensitive taxpayer information effectively be protected? To what extent would exchange-of-information rules apply)?

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- Guidance on whether information submitted or proposals made during NBDR discussions may or may not be used in subsequent court proceedings or other contexts (so-called "without prejudice rules").[10]

- Initiation of the process -- e.g., who, when, to whom, how?
    - Logistics of the process (place, language, translations, participants, transcripts and meeting minutes etc.).

- Possibility of allowing the Neutral Third to talk to one party in the hope of finding grounds for mutual agreement, without sharing the contents of the discussion and/or results with the other party (so-called "caucuses").

- Participation of the taxpayer (inclusion, exclusion, rights to be heard).
    - [***Note:*** Chapter 6 should follow whatever resolution of this issue is reached in Chapter 5 on MAP]

- Possibility of separate discussions between the CAs independent of the Neutral Third seeking to achieve mutual agreement.

- Termination of proceedings.[11]

- Possible form of cost allocation between the CAs or the taxpayers.

6.3 Expert Advice.

Expert advice is a NBDR mechanism which consists of a technical expert reviewing evidence presented by the parties.[12] This procedure could involve an independent third party acting as an expert and rendering advice, in contrast to a judge or arbitrator appointed to decide a dispute. In such a procedure, the determination made by the expert would be advisory in nature with respect to the issue in question, as the parties determine to be appropriate. Expert advice is especially applicable with respect to disputes of valuation or those of a purely technical nature in commercial or business sectors.[13] It is also beneficial in cases involving special sectors of the economy or certain subjects such as financial services, hydrocarbons, environmental issues, water resources, or renewable energy sources.[14]

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[10] This characteristic, at a domestic level, has provided confidence to parties to abandon part of their claims in the effort to find a solution to the conflict at hand. Thus, it is recommended that CAs, when designing a NBDR framework, provide that all of their proposals, offers, and positions will be safeguarded by the expert or mediator and will not be of public knowledge. By not setting any precedent, the CA know that the (possible) agreed solution will not be binding or repeatable in any other case and cannot be used in a future domestic court procedure.

[11] It is submitted that the suspension or termination of NBDR should always be possible if at least one CA, after serious consideration, comes to the conclusion that NBDR will not be effective. Flexibility should prevail over formalism, given in particular that CAs have already demonstrated their good will to find an amicable solution through the participation in a MAP.

[12] http://siteresources.worldbank.org/INTECA/Resources/15322_ADRG_Web.pdf

[13] Ibidem.

[14] Expert advice could include a preliminary assessment of facts, evidence, or legal merits where parties agree on the nature and impact of an issue and the need for an independent evaluation. Such a process can be designed to facilitate the MAP process.

In the MAP context, expert advice could involve engagement, by one or both tax administrations, of a lawyer or other professional with experience in the technical, procedural, or other issue that the parties are unable to resolve. For example, expert advice could occur when a tax administration concludes that its position in a potential transfer pricing or other matter would benefit from review by an independent person. This could take place before or during a CA proceeding. An illustration of such a process in the BusCo Case Study is presented below:

> **BusCo Case Study**
>
> As Country A and Country B discussed the potential of engaging in a NBDR process, it became apparent that the critical difference between their positions related to the factual questions relating to the LocalCo market development activities which Country B believed constituted valuable intangibles for which LocalCo had borne the costs and developed the resultant expertise.
>
> Country B proposed that an expert be engaged to provide an independent assessment of the factual elements underlying its position. Country A agreed and the parties worked out a schedule of timing so that the overall MAP process could proceed as efficiently as possible.
>
> A mutually agreed upon expert was engaged. Within the agreed upon time period, the expert advised that the market development activities of LocalCo were generally within the range of normal functional elements of distributors of motor vehicles. On the other hand, the expert advised that LocalCo had developed a unique warranty process that had materially expanded the lifespan of the buses, whether purchased new or used, which had resulted in a continually increasing market share. The warranty process involved an annual customer payment for a lifetime warranty, with LocalCo having developed the service team to annually address issues of each vehicle. The expert advised that the warranty process had been independently developed by LocalCo taking advantage of elements of the local market.
>
> With this factual input, the parties proceeded with their negotiation.

In short, an expert evaluation or determination process can be flexible, efficient, and timely where both parties are in agreement on the potential benefits of expert advice and agree upon the way forward.

Unilateral Use of Expert Advice: In some situations, it may be appropriate for one or the other CA party to engage an expert on its own, perhaps for confirmation of certain factual matters. For example, in the BusCo Study, the Country B tax authority, which has little actual experience in MAP proceedings, could decide that it would benefit from an independent analysis elements of its position. Accordingly, it could independently engage an expert for this purpose. The engagement could be limited to factual or technical matters, or both (and would presumably not address procedural matters). The expert could be engaged to review documents only, or meetings could be scheduled. It could also result in an oral or written report, as may be appropriate to the Country B tax authority. In such an informal process, the expert advice should be delivered in an efficient, timely manner. Costs would be those of the tax authority that engaged the expert.

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From Country B's standpoint, such a process provides an external check on its internal determination. In such a unilateral consultation by Country B, there would need to be an engagement agreement with the expert, taking into consideration many of the issues identified for a CAA (for example, scope of work, time frame, and issues of confidentiality).

6.4. Mediation.

Mediation is a form of process-related assistance that involves the use of a mediator or facilitator to aid in providing a perspective on the discussions, identify issues that prevent resolution of a conflict, bringing a problem solving focus to the negotiating table, and facilitate mutual agreement between the parties, thereby avoiding further treaty procedures or ultimate litigation in either or both countries. It is is not a procedure for one party to defeat the other; rather it is to decide the solution to their conflict (a win-win scenario).

The degree of activity of the mediator can range from a rather passive to a more active role, depending on the needs of the parties and the nature of the dispute. It can include:

- Monitoring the process or administrating the case.
- Guiding the discussions.
- Promoting a positive, consensual working relationship between the parties.
- Requesting information.
- Focusing the debate on key issues.
- Discussing (and potentially actively evaluating) with the parties the strengths and weaknesses of their respective arguments.
- Making process-related suggestions (e.g., commissioning of an expert; undertaking joint technical discussions in neutral facilities, agreeing on common / objective criteria, meeting with taxpayer, or otherwise).
- Offering input on total or partial solution of the dispute via compromise of respective positions.
- If the parties so wish, recommending concrete solutions to the dispute.

This mechanism is frequently used to resolve various types of disputes since it is a flexible process, conducted in confidentiality, in which a neutral person actively assists parties in working towards a negotiated agreement of a dispute or difference.[15] In many cases, the very existence of an independent third person helps the parties formulate their respective positions more rationally and more objectively, thereby enhancing the chances of an agreement. Thus, the use of mediation can often make negotiations more efficient and help the parties avoid the waste of time and resources

[15] See http://siteresources.worldbank.org/INTECA/Resources/15322_ADRG_Web.pdf

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resulting from stalemate in negotiations. This increase of efficiency is often underestimated by disputing parties.

The effectiveness of tax mediation depends largely on the role played by the mediator in the process. While it may be thought that the most important thing to carry out this role effectively is a specific technique to reach the agreement between the parties, the field experience reveals that creating awareness in the parties about what mediation is and how it works is a key issue. For this purpose, the mediator´s role is fundamental.

By taking into account these premises, the parties may understand that compromising their respective positions opens a real possibility of achieving an agreement controlled by themselves.

Mediation could be adapted to the MAP process in specific situations. It could be especially useful between countries with different levels of experience. As discussed above, it is a reality of the current world of cross-border tax dispute that many countries, especially LDCs, have limited experience in MAP processes. Mediation and other forms of NBDR can be helpful in building confidence and experience in the handling of such disputes to protect the tax base of the respective countries.

An illustration of mediation utilization in the BusCo Case Study follows:

> **BusCoCase Study**
>
> Armed with such input, Country B is confident that its assessment has a reasonable basis, though understanding that such issues are subject to material differences of opinion in specific situations (even among seasoned experts).
>
> When Country A and Country B continued the MAP process, Country B presented the results of its expert advice process, which Country A found very interesting. Country A had resisted any suggestion that LocalCo may have developed a marketing intangible. Country B advised of its continuing belief that its position was a reasonable application of pertinent arm’s length principles, though recognizing that there was a range of possible results for specific cases. Country B recognized that its assessment was at the high end of the range and it was prepared to negotiate to find a mutually acceptable result. In turn, Country A indicated interest in the Country B expert advice that there may be a factual basis for the Country B position. Accordingly, Country A advised that it would re-examine its position.
>
> In continuing discussions, the parties made considerable progress but material differences remained. Country A suggested that they consider a binding arbitration process to provide an appropriate resolution. Country B was concerned about its lack of experience in binding dispute resolution, as compared to Country A. Accordingly, it proposed that they undertake a non-binding mediation process as a means of seeking agreement. Both countries recognized that a mutually acceptable resolution would, in all likelihood, be somewhere between their respective positions. Accordingly, they agreed to engage an independent mediator to address the issues.

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As a result of the mediation process, an agreement was reached which was acceptable to Country A, Country B, and the taxpayers. Accordingly, the appropriate treaty processes were undertaken to implement the agreement, including correlative relief.

In a situation like the BusCo Case Study, the role of the mediator may offer an opportunity for the CAs to view a specific case, or the MAP process itself, from a different perspective. Such perspective could be acquired through the mediator's restatement of the positions or of the critical issues, which could highlight elements of the case or procedural context that are not possible to be recognized when seen from the perspective of a tax administration defending its taxing powers, adjustments, or the provision of relief from double taxation; or from the perspective of a MNE seeking to protect its own interests. Mediation may be the key in finding a solution for some of the more systemic issues of a MAP negotiation.

Role of the Mediator: Special importance should be given to the role of the mediator who normally acts as a facilitator to aid parties to overcome their differences, providing guidance in identifying issues, engaging in joint problem-solving, and exploring creative settlement alternatives. Depending on the nature of the dispute, parties may require the mediator to go beyond this role and act as an evaluative mediator, providing factual and even legal evaluation of the case; yet, parties retain the full control of the decision to settle the dispute and specify the terms of resolution.[16]

Unanticipated Problems: In any such mediation process, it should be anticipated that unforeseen issues will arise. For example, in the BusCo Case Study a disagreement on a factual issue concerning the local market warranty program developed by LocalCo. This could also evolve into a technical problem in the sense of whether the program could or should be characterized as a marketing intangible for transfer pricing purposes.

In such a situation, the goal of a mediator would be to identify the key controversies and the issues surrounding them, seek a convergence of views of the two countries, and help the parties resolve critical misalignments that block resolution.

Choice of Tested Party in Transfer Pricing Cases: The choice of the tested party, which is typically the more limited scope party, can have a substantial effect on the profitability of each party. Differences between the posture of countries in CA proceedings often result from disparity on this issue. For example:

BusCoCase Study: The system or combined profits of the BusCo group, including those of LocalCo, will likely vary significantly from year to year. Prior to the change of methodology, LocalCo was an "entrepreneur" compensating BusCo via one-sided transfer pricing methodologies. As a result, residual profit or loss from the LocalCo operations resided in it and Country B. When the methodology was changed so that LocalCo was made a "limited risk manufacturer/distributor," the residual profit or loss was in BusCo.

[16] http://www.cedr.com/CEDR_Solve/services/mediation.php

> As the mediator evaluated the positions of Country A and Country B, it was apparent that the critical issue was the conversion from one model and tested party (BusCo to LocalCo) was the critical issue.

In such a situation, the mediator's objective is not necessarily to force a choice or a solution regarding tested party, but to explore options and alternatives to align the two countries. In this regard, it may be appropriate to consider further economic analysis or accounting for the impact of hard-to-value intangibles on profits. Another approach could be to evaluate the combined income data for the periods in question (and use a two-sided transfer pricing method, profit split, for a high level view of the overall situation. Such steps may enable the mediator to bring the parties closer together in moving forward towards settlement.

Role of Domestic Experience: *[***Note:** *Is this type of comment best addressed in Chapter 3 on domestic processes, with a cross-reference here?]* Mediation is already used in some countries. For example, in the United Kingdom, the CA (HMRC) allows an advance dispute resolution ("ADR") process in which a specialist is brought into the proceedings to facilitate the negotiations.[17] The specialist is not necessarily an expert in taxation, but in ADR. The CA maintains responsibility for resolution (sovereignty) as negotiations proceed with the independent party. The proceedings may also be more efficient and, consequently, less costly. Further, the taxpayer's right to appeal is maintained. According to HMRC, the benefits of such ADR include:

- Impetus towards resolution via a fresh approach.
- Issues can be "unpacked" and alternatives explored on a confidential basis, with a potential lasting benefit beyond the discussions of the dispute itself.
- Even if the dispute is not resolved, respective positions can be sharpened possibly, prepared more effectively for litigation.

HMRC reports that most such ADR events have been concluded in one day and the average elapsed time from application to resolution was twenty-four weeks in large or complex cases and sixty-one days in small and medium-sized enterprise cases, which is a significant contrast with the multi-day hearings and seventy week average of the process of appeal for such cases.[18]

Role of an Ombudsman: *[***Note:** *Is this type of comment best addressed in Chapter 3 on domestic processes, with a cross-reference here?]* The role of an ombudsman is typically focused in safeguarding taxpayers' rights at the domestic level, and its substantive participation in international tax disputes is non-existent.

However, its role from an international standpoint may still be crucial in MAP access issues. The ombudsman can act as a guardian body to ensure that the tax administration of its country properly applies and interprets the provisions of the Convention and thus, prevent the taxpayer from being

[17] See HM Revenue and Customs, Tax Disputes: Alternative Dispute Resolution (ADR) 2014, http://www.gov.uk/tax-disputes-alternative-dispute-resolution-adr.
[18] See Lloyd & Dennis, Tax Journal "Q&A: How Is ADR Working for Large Businesses?" (Feb. 5, 2015).

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denied access to the MAP in an unjustified manner. This issue, undoubtedly, could have an impact in the resolution of international tax disputes.[19]

6.6. Combining Several Forms of NBDR in MAP.

The procedural roles of experts and mediators are to a certain extent complementary (as reflected in paragraph 6.2.2., above, with respect to issues to be addressed in a CAA for NBDR). Whereas the mediator relies on an ability to steer and frame the discussions between the parties and engage them in the exploration of potential solutions, the expert provides the parties with highly specialized technical expertise (in tax cases, one could for instance think of advice on comparable market prices at "arms-length").

There are ways to combine the skill-sets of mediators and experts in order to enjoy the benefits of each of these procedures. Three possibilities are outlined below.

6.6.1. Agreement on Methods and Criteria: One way is for a mediator to help the parties find an agreement on methods and criteria, before the dispute is submitted to an expert. In fact, most successful mediations include a phase in which the parties discuss and agree on underlying principles, methods or criteria in order to resolve their dispute. In most disputes, there is more than one "objective" method and thus more than one "reasonable" perspective (as in the BusCo Case Study), which is often the root of disagreement. Acknowledging, reconciling, or combining the underlying rationales of the parties is crucial for reaching an agreement. Once the parties have agreed on a common methodology, an expert can carry out her operations more easily. In this way, mediation can effectively utilize expert evaluation (or expert determination).

6.6.2. Utilization of Previous Expert Report: Another way is to conduct mediation on the basis of an existing expert report. In this scenario, the mediator would discuss the results of the expert investigations with the parties and, potentially, the expert. This can be particularly useful in cases in which the parties have a different interpretation of the expert report or in which one party contests the methodology of the expert. It should be noted that an earlier appointment of the mediator often helps to avoid such difficulties before they arise (as in the first possibility noted above). Once differences of view on the methodology applied by the expert have arisen, it may often be difficult to solve these through non-binding mechanisms of dispute resolution.

6.6.3. Parallel Mediation and Expert Advice: A third way of combining these means of dispute resolution is to embed expertise into mediation, while the mediator and expert are working in parallel. The mediator would have a more procedural role and be responsible for moderating the overall discussions, whereas the expert (usually under the direction of the mediator) would inject valuable expertise and provide guidance for the discussions between the parties. The expert's work can be made useful either through a single written expert report or oral expert testimony, or on a continuing basis throughout the discussions. In certain circumstances, it may also be useful to

[19] This specific role has been played by the Mexican Tax Ombudsman Agency (*PRODECON,* by its acronym in Spanish). Its complaint procedure has enabled this public body to meet and discuss with the Mexican tax authority when access to a MAP procedure, in accordance with taxpayers view, is being incorrectly denied.

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allow the mediator to have separate discussions with the expert, if the mediator feels that he needs more information in order to better orientate the discussions.

Combining mediation and expert evaluation allows for much flexibility. Engaging both a mediator and an expert at the same time is certainly costlier than engaging either one of these.

6.7. NBDR as a Precursor to Arbitration.

NBDR could be envisaged either as an alternative to arbitration[20] or as a supplementary means of dispute resolution, preceding arbitration.

Providing for binding dispute resolution as a measure of last resort would further the effectiveness of the tax treaty provisions because it gives CAs an additional incentive to apply the tax treaty consistently. At the same time, a multi-tiered approach including NBDR would ensure that cases are, as a rule, solved by mutual agreement rather than by the decision of arbitrators.

Further, NBDR as a precursory step to arbitration can increase the efficiency of an arbitration, notably because the debate can more easily be focused on the key issues ("terms of reference"). If, during the NBDR phase, an independent expert has carried out specific fact-finding tasks or economic evaluations, the parties may agree that the expert report is used during an ensuing arbitration.

In multi-tiered procedures it is, however, crucial that the sequence of stages does not delay the proceedings overall. This should be ensured by providing for strict (default) timelines, which the CAs can only extend jointly and not indefinitely. NBDR should be completed at the point in time when referral to arbitration would otherwise become mandatory, so that it does not extend the maximum duration of the proceedings by delaying the initiation of arbitration.

6.8. Sample CAA.

[Note: Would it be appropriate in the final version of Chapter 6 to include a sample CAA agreement?]

[20] See Chapter 8.