ANNEXURE 11

DAVIS TAX COMMITTEE: SECOND INTERIM REPORT ON BASE EROSION AND PROFIT SHIFTING (BEPS) IN SOUTH AFRICA

SUMMARY OF DTC REPORT ON ACTION 14: MAKE DISPUTE RESOLUTION MECHANISMS MORE EFFECTIVE

The OECD recommends that the introduction of the measures developed to address base erosion and profit shifting pursuant to its 2013 *Action Plan on Base Erosion and Profit Shifting* should not lead to unnecessary uncertainty for compliant taxpayers and to unintended double taxation. Improving dispute resolution mechanisms is therefore an integral component of the work on BEPS issues. Article 25 of the OECD Model Tax Convention provides a Mutual agreement procedure (MAP) mechanism, independent from the ordinary legal remedies available under domestic law, through which the competent authorities of the Contracting States may resolve differences or difficulties regarding the interpretation or application of the Convention on a mutually-agreed basis. MAP is of fundamental importance to the proper application and interpretation of tax treaties, in order to ensure that taxpayers entitled to the benefits of the treaty are not subject to taxation by either of the Contracting States which is not in accordance with the terms of the treaty. Action 14 of the BEPS Action Plan, which deals with making dispute resolution mechanisms effective, aims to strengthen the effectiveness and efficiency of the MAP process. The aim is to minimise the risks of uncertainty and unintended double taxation by ensuring the consistent and proper implementation of tax treaties, including the effective and timely resolution of disputes regarding their interpretation or application through the mutual agreement procedure. Countries have agreed to important changes in their approach to dispute resolution, in particular by:

- having developed a minimum standard with respect to the resolution of treaty-related disputes,
- committed to its rapid implementation and
- agreed to ensure its effective implementation through the establishment of a robust peer-based monitoring mechanism that will report regularly through the Committee on Fiscal Affairs to the G20.

The minimum standard will:

- Ensure that treaty obligations related to the mutual agreement procedure are fully implemented in good faith and that MAP cases are resolved in a timely manner;
- Ensure the implementation of administrative processes that promote the prevention and timely resolution of treaty-related disputes; and
- Ensure that taxpayers can access the MAP when eligible.

The minimum standard is complemented by a set of best practices. The monitoring of the implementation of the minimum standard will be carried out pursuant to detailed terms of reference and an assessment methodology to be developed in the context of the OECD/G20 BEPS Project in 2016. In addition to the commitment to implement the minimum standard by all countries adhering to the outcomes of the BEPS Project, 20 OECD countries have declared their commitment to provide for mandatory binding MAP arbitration in their bilateral tax treaties, as a mechanism to guarantee that treaty-related disputes will be resolved within a specified timeframe. The OECD notes that this represents a major step forward as together these countries were involved in more than 90 percent of outstanding MAP cases at the end of 2013, as reported to the OECD.

RECOMMENDATIONS ON MAP FOR SOUTH AFRICA

For South Africa to determine the approach it will take with respect to Action 14, it has to consider its treaty partners and its stated economic policy to begin a gateway to foreign investment into Africa. MAP has not been very effective among African countries. South Africa has participated in a minimal number of MAP processes, presumably because of taxpayers have not applied for MAP and also due to capacity issues. Even though South Africa has a wide network of double tax treaties it has only 3 treaties which include binding arbitration clauses: These are the treaties with Canada,[1] Netherlands[2] and Switzerland.[3] Nevertheless, MAP is likely to become increasingly important as more treaties are concluded with less developed countries and the process becomes more accessible and reliable. As a developing country, it would be in the interest of South Africa to make use of the UN Guide to MAP under Tax treaties[4] whose primary focus is on the specific needs and concerns of developing countries and countries in transition, and would be instrumental for South Africa to follow in ensuring effective MAP. This UN Guide seeks to provide countries that have little or no experience with MAP with a practical guide to that procedure.[5]

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1 SARS "Convention Between The Republic of South Africa and Canada For The Avoidance of Double Taxation And The Prevention Of Fiscal Evasion With Respect to Taxes on Income" Government Gazette No. 17985, Date of entry into force 30 April 1997.

2 SARS "Convention Between The Republic Of South Africa And The Kingdom Of The Netherlands For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income And On Capital" Government Gazette No. 31797, Date of entry into force 28 December 2008.

3 SARS "Convention Between The Republic Of South Africa And The Swiss Confederation For The Avoidance Of Double Taxation With Respect To Taxes On Income" Government Gazette No. 31967, Date of entry into force 27 January 2009

4 UN "Guide to Mutual Agreement Procedure in Tax Treaties" (2012). Available at http://www.un.org/esa/ffd/tax/gmap/Guide_MAP.pdf accessed 16 May 2014.

5 Ibid.

- South Africa should adopt the OECD minimum standards with respect to MAP.
- SARS needs to be more active in supporting South African taxpayers during MAP processes. This is especially so in treaties involving African countries where the MAP process is not developed and is not effectively applied. A critical need in this regard relates to cases where some African countries incorrectly claim source jurisdiction on services (especially management services) rendered abroad and yet those services should be considered to be from a South African source. These countries levy withholding taxes from amounts received by South African residents in respect of services rendered in South Africa. The withholding taxes are sometimes imposed even if a treaty between South Africa and the relevant country does not have an article dealing with management fees or and even if South African residents do not have permanent establishments in these countries. In response to the double taxation concerns that South African taxpayers face and to encourage investors to see South Africa as an attractive headquarter location, National Treasury enacted section 6*quin* which provides a rebate for management fees and technical service fees even though use of MAP in double tax treaties is the right forum that should have been employed to resolve these concerns. However South Africa residents had little success in challenging these matters with the tax authorities of the other countries and yet SARS was also not able to enforce the proper application of the treaties with these countries.[6] Although section 6*quin* ensured that South African taxpayers are not subjected to double taxation,[7] its application implied that South Africa had departed from the tax treaty principles in the OECD MTC in its treaties with the relevant countries, in that it has given them taxing rights over income not sourced in those countries. As a result, South Africa effectively eroded its own tax base as it is obliged to give credit for taxes levied in the paying country. In terms of 2015 Taxation Laws Amendment Act, National Treasury repeal of section 6*quin* from years commencing on or after 1 January 2016.[8] National Treasury explains that South Africa is the only country with a provision (like s 6*quin*) which goes against international tax and tax treaty principles in that it indirectly subsidises countries that do not comply with tax treaties and that it is a compliance burden for SARS. National Treasury also had concerns that some taxpayers were abusing the relief offered by the section. As noted above MAP under tax treaties is the forum that ought to be used to solve such problems. As a member of the African Tax Administration Forum (ATAF) which promotes and facilitates mutual cooperation among African tax administrators), South Africa should strongly advocate for ATAF to ensure that member countries enforce their treaty obligations and ensure that taxpayers can access MAP

6 PWC “Comments on DTC BEPS First Interim Report” (30 March 2015) at 22.
7 Ibid.
8 Section 5 of the Draft Taxation Laws Amendment Bill 2015.

- To ensure the effectiveness of MAP it is important that the performance measures against which officials working on MAP are measured should not be based on factors such as revenue obtained. Such officials should have a different reporting structure to that of the SARS audit team, because of the fact that, in a MAP case, a portion of tax will inevitably be given up by the competent authority. This is highlighted in the OECD Final report on Action 14 which provides that "countries should not use performance indicators for their competent authority functions and staff in charge of MAP processes based on the amount of sustained audit adjustments or maintaining tax revenue".[9]
- To ensure the effectiveness of MAP, when an application for MAP is made, it must be referred to an independent and separate unit that deals with MAP, not to e.g. the transfer pricing audit unit. This is in line with the OECD recommendation on Action 14 which states that "countries should ensure that the staff in charge of MAP processes have the authority to resolve MAP cases in accordance with the terms of the applicable tax treaty, in particular without being dependent on the approval or the direction of the tax administration personnel who made the adjustments at issue or being influenced by considerations of the policy that the country would like to see reflected in future amendments to the treaty."[10]
- Attention should be given to intensive recruitment and robust training of personnel by SARS to deal with MAP issues. This will, in turn, clearly require that funding be made available. A lack of sufficient resources (whether staff, training, funding, etc.) will inevitably result in unsatisfactory outcomes and a backlog of cases due to delays by the competent authority in processing such cases. Outsourcing could possibly be considered as a temporary solution.
- Since most MAP cases deal with transfer pricing matters, it is important for South Africa to include the Article 9(2) secondary adjustment in those tax treaties where it has not yet been included.
- Advance pricing agreements (APAs) lessen the likelihood of transfer pricing disputes. Lack of an APA program in South Africa is an inhibitor to foreign direct investment as it removes the opportunity to seek certainty on transactional pricing, particularly when Multinationals expand into the rest of Africa. It is acknowledged that there are scarce resources within the transfer pricing arena to enable a separate and independent unit to deal with APA's. A possible temporary measure could be to outsource this to recognised experts with oversight by senior SARS officials. When APA are adopted, consideration should be given to the possibility of combining MAP proceedings for a recurring transfer pricing issue with a bilateral APA with rollback. This would be in line with the OECD recommendation that "countries with bilateral advance pricing arrangement (APA) programmes should provide for the roll-back of APAs in appropriate cases, subject to the applicable time

[9] OECD/G20 2015 Final Report on Action 14 in para 28.
[10] OECD/G20 2015 Final Report on Action 14 in para 27.

limits (such as statutes of limitation for assessment) where the relevant facts and circumstances in the earlier tax years are the same and subject to the verification of these facts and circumstances on audit".[11]

- SARS should not influence taxpayers to waive the right to MAP nor should taxpayers be prohibited, as part of settlement negotiations, from escalating the portion of tax suffered to the competent authority for relief from double taxation. This would amount to a unilateral decision, without due regard to the spirit of the double tax treaties or the treaty partner.
- Although South Africa has guidelines and regulations on domestic dispute resolution and litigation, there is no guidance on how to resolve disputes through the treaties. There is confusion as to how SARS approaches this, who the appropriate competent authority is in this regard and how the process should be followed. For instance some countries will suspend domestic resolution processes pending the outcome of a MAP appeal whereas other countries require the domestic remedies to be exhausted before entertaining a MAP appeal. Clear guidance on when SARS will entertain MAP needs to be given together with an appropriate process guide for taxpayers similar to the guide issued for domestic resolution. Such guidance should be clear and transparent, not unduly complex and appropriate measures should be taken to make such guidance available to taxpayers. The Guidance should contain information such as:
  - When will MAP be applied;
  - Applicable time limits in which a taxpayer can approach the Competent Authority;
  - Who the Competent Authority is;
  - What documents are required to be submitted with any application for MAP;
  - Interaction of MAP with domestic legislation;
  - Estimated timelines; and
  - Liabilities of the Competent Authority.
- Since most MAP disputes concern transfer pricing, it is important that SARS Interpretation Note on Transfer Pricing is finalised. Clear guidance should also be provided with respect to thin capitalisation rules. Other MAP disputes relating to controlled foreign company rules (CFC) and interest deductibility could be prevented by simplifying the complex CFC rules and the interest deductibility provisions.
- The current audit procedure in South Africa includes two aspects of an enquiry, a risk assessment process which is to determine whether an audit is warranted, and a full audit process. The roles and responsibilities of these two are becoming blurred in certain circumstances, which places the taxpayer in a position of uncertainty as to whether the matter is under audit or not. The respective roles and responsibilities therefore need clarifying and SARS

[11] OECD/G20 2015 Final Report on Action 14 in para 33.

should be required to inform the taxpayer as to whether their matter is under audit or not. Further the audit process often creates problems for taxpayers in that SARS often requires extremely detailed information from a taxpayer, in a relatively short period of time, without any timeline or time commitment being placed on SARS to respond resulting in an unreasonably long time passing, this needs to be addressed through better audit governance measures.

- The timing for applying for MAP needs to be clarified. Under Article 25(1) of the OECD UN MTC where a person considers that the actions of one or both contracting states results or will result in taxation that is not accordance with the provisions of the treaty, that person may irrespective of any remedies available under domestic law, present his case to the competent authorities of the contracting states in which he is resident (or the state in which he is a national). The case has to be brought to the attention of the competent authorities within three years from the first notification that the relevant tax is not in accordance with the provisions of the treaty. In South Africa, the timing is not clear and it appears that that the domestic rules govern the process and acceptance of such applications. It is understood that with scarce resources it would be inefficient to entertain a domestic appeal and competent authority application simultaneously. SARS needs to clarify the time when it will entertain a competent authority application, that is, whether it is once the taxpayer's objection has been disallowed, or at the same time as the appeal. This needs to be clarified in some form of binding, written communication. In this regard, it is recommended that SARS keeps to the time limit as is recommended in the OECD Commentary on Article 25(1). Further, to the extent the domestic appeal is suspended pending the outcome of the MAP, this should be clearly stated in the guidance, together with advice on payment suspension.
- In relation to the "Pay now, argue later" principle as applied by the SARS, if a MAP matter takes years before being resolved, SARS should be cognisant of the fact that not permitting the suspension of payment pending the outcome of MAP can be extremely detrimental to the taxpayer. The OECD recommended best practice on Action 14 to ensure taxpayers can access MAP, is that countries should take appropriate measures to provide for a suspension of collections procedures during the period a MAP case is pending. Such a suspension of collections should be available, at a minimum, under the same conditions as apply to a person pursuing a domestic administrative or judicial remedy. [12] This recommendation should be followed in South Africa.
- Many developing countries, do not consider themselves yet ready for mandatory binding arbitration in the international taxation context. India and Brazil made it clear in the BEPS discussions on the matter that they would not

[12] OECD/G20 2015 Final Report on Action 14 in para 50.

be involved in binding mandatory arbitration.[13] Developing countries are very wary of adopting binding arbitration provisions in their tax treaties, since normally in arbitration cases the winning country gets the tax revenue and the other loses. Mandatory binding arbitration is considered unfair since it entails entrusting decisions involving often millions of dollars to a secret and unaccountable procedure of third party adjudication. Developing countries hold the view that arbitration can only be effective and accepted if the rules to be applied are clear, and if the procedures are open and transparent, including the publication of reasoned decisions. As a developing country, these matters should be of concern to South Africa too. For that matter, South Africa should call for measures to be in place to make the arbitration process more transparent and it should only commit to the process if the rules are clear and transparent. Until the MAP arbitration process is made more transparent, South Africa should also be cautious about committing to an arbitration provision in the envisaged Multilateral Instrument under Action 15 of the OECD BEPS Action Plan. If South African becomes a party to the Multilateral Instrument, it should register a reservation not to commit to mandatory arbitration until the concerns regarding this process are rectified.

- Since mandatory arbitration is viewed by the OECD and taxpayers as a means of speedily resolving MAP, South Africa should call for international measures to be put in place to ensure transparency in the arbitration procedures:
    - South Africa should join the call for an international panel of arbitrators, for instance under the auspicious of the United Nations to be formed that comprises a panel of members from both developing and developed countries. Decisions of such a panel would be considered neutral and fair to the interests of all countries.
    - At regional level, South Africa should recommend that a pool of arbitrators be formed, with the necessary skills and qualifications, from among ATAF member countries. The ATAF member countries could then draw on arbitrators from that pool in cases where the MAP was between two ATAF-member countries. We note in this regard that a similar idea is successfully implemented under the EU Arbitration Convention, which pool comprises a pool of arbitrators appointed from EU member states.
    - South Africa should call for MAP results and agreements reached (even the "anonymised" versions) to be published annually, which could be in redacted manner (removing aspects that could raise confidentiality concerns) – this will provide further guidance and proactively resolve other potential future disputes.
    - Exchange of existing best practices between SARS and other revenue authorities should be strongly encouraged. South Africa should in

[13] UN Committee of Experts on International Cooperation in Tax Matters "Secretariat Paper on Alternative Dispute Resolution in Taxation" (8 October 2015) in para 21.

particular adopt the OECD recommendation regarding Best Practice 1 (inclusion of Article 9(2) in its tax treaties); Best Practice 2 (adopt appropriate procedures to publish MAP agreements reached); Best Practice 5 (implement procedures that permit, after an initial tax assessment, taxpayer requests for the multiyear resolution through the MAP of recurring issues with respect to filed tax years, where the relevant facts and circumstances are the same); Best practice 6 (take appropriate measures to provide for a suspension of collections procedures during the period a MAP case is pending); Best Practice 7 (take appropriate measures to provide for a suspension of collections procedures during the period a MAP case is pending); Best Practice 8 (published MAP guidance explaining the relationship between the MAP and domestic law administrative and judicial remedies); Best Practice 9 (publish MAP Guidance which provides that taxpayers will be allowed access to the MAP where double taxation arises in the case of bona fide taxpayer-initiated foreign adjustments permitted under the domestic laws of a treaty partner); Best Practice 10 (publish guidance on the consideration of interest and penalties in the MAP).

DTC REPORT ON ACTION 14: MAKE DISPUTE RESOLUTION MECHANISMS MORE EFFECTIVE

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1 INTRODUCTION

Where disputes arise between taxpayers and the revenue authority, such disputes are usually resolved through the judicial and administrative remedies provided by the domestic law of the country. The judicial remedies involve resolution of tax disputes through the country's court system. Due to the complexities and amounts of monies involved, tax cases are also often settled out of court.

When a country enters into a double taxation treaty with another country, often the treaty becomes part of the domestic tax law of that country.[1] This implies that disputes that arise in a treaty context can also be resolved through the county's court system. However a taxpayer may find that a resolution of the dispute under the domestic court system may not be satisfactory due to the international nature of the dispute.

Since there is no international court to deal with disputes that could arise from tax treaties; resolution of such disputes is normally provided for under the Mutual Administration Procedure (MAP) as set out in Article 25 of relevant treaties that are based on the OECD or the UN MTC. In terms of Article 25(1), MAP is in principle available to the taxpayers in addition to their normal legal (judicial and administrative) remedies provided by the domestic law of the Contracting States. Because the constitutions and/or domestic law of many countries provide that no person can be deprived of the judicial remedies available under domestic law, a taxpayer's choice of recourse is generally only constrained by applicable time limits (such as those provided by a domestic law statute of limitation or by Article 25(1)) discussed below. There could also be constraints in circumstance where tax administrations will not deal with a taxpayer's case through both the MAP and a domestic court or administrative proceeding at the same time (*i.e.* one process will typically take precedence over the other).[2]

The MAP is administered by the "competent authorities" who are generally those named under Article 3(f) of the treaties based on the OECD MTC. Article 25 of both the OECD and UN MTC requires the competent authorities of the contracting States

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[1] In South Africa for instance, section 231(2) of the Constitution of the Republic of South Africa, 1996; read together with section 108(1) of the Income Tax Act 58 of 1962, provide that as soon as the double tax agreement is ratified and has been published in the *Government Gazette*, its provisions are effective as if they had been incorporated into the Income Tax Act. See A.W. Oguttu, *Curbing 'Treaty Shopping': The 'Beneficial Ownership' Provision Analysed from a South African Perspective* XL *CILSA* (2007) at 252.

[2] OECD/G20 2015 Final Report on Action 14 in para 51.

to settle "questions relating to the interpretation and application of the Convention"[3] and resolve "difficulties arising out of the application of the Convention in the broadest sense of the term."[4] This includes procedural aspects of the application of the provisions of the treaty.

2 THE MUTUAL AGREEMENT PROCEDURE

Article 25(1) of the OECD Model Tax Convention (MTC) provides that where a person considers that the actions of one or both contracting states results or will result in taxation that is not accordance with the provisions of the treaty, that person may irrespective of any remedies available under domestic law, present his case to the competent authorities of the contracting states in which he is resident (or the state in which he is a national).

The competent authority shall endeavour, if the objection appears to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States. The case has to be brought to the attention of the competent authorities within three years from the first notification that the relevant tax is not in accordance with the provisions of the treaty. The Commentary on the OECD explains that the three year time limit is intended to protect administrations against late objections. The time limit must be regarded as the minimum so that the contracting states can agree on longer periods in the interest of the taxpayer.[5]

Article 25(2) provides that where the aggrieved person presents an objection before the competent authorities of the state in which he is resident, and the matter appears to be justified, that competent authority shall endeavour to resolve the matter. Where it cannot arrive at a satisfactory solution by itself, the matter can be resolved by mutual agreement with the competent authority of the other contacting state. In instances where domestic law could hinder the effectiveness of the MAP through domestic law time limits that may prevent a tax assessment being amended in favour of the taxpayer,[6] Article 25(2) seeks to overcome this difficulty by providing that any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the contracting states. Thus MAP provides a treaty dispute resolution mechanism irrespective of any remedies available under domestic rules.

3 Paragraph 2 of the Commentary on Article 25 of the UN MTC.
4 Paragraph 1 of the Commentary on Article 25 of the OECD MTC.
5 Paragraph 20 of the Commentary on article 25 of the both the OECD and UN MTC
6 United Nations, *Administration of Double Tax Treaties* at 167.

Article 25(3) provides that the competent authorities may consult each other to resolve by mutual agreement any difficulties or doubts that arising from the interpretation or application of the treaty. They may also consult together to eliminate any double taxation cases not provided for in the treaty. In terms of Article 25(4), joint commissions consisting of themselves or their representatives could also be utilised.

A factor that has been a major hindrance in the past to the effectiveness of MAP internationally has been the lack of a requirement for the competent authorities to reach agreement.[7] A conclusion could only be reached if both parties come to an agreement through their consultations. Article 25 did not provide for a mechanism of dealing with cases where no agreement is reached. This led to long procedures and a backlog of unresolved issues.

2.1 ARBITRATION UNDER THE MAP PROCEDURE

In 2004 the OECD issued a report on "Improving the Process for Resolving International Tax Disputes"[8] which proposed the development of a binding arbitration process to resolve disagreements arising in the course of a MAP case. This culminated in the inclusion of an arbitration clause in the MAP procedure, which is covered under article 25(5) of both the OECD and UN MTCs.[9] Article 25(5) of the OECD MTC states that

> Where,
>
> a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and
> b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State,
> c) any unresolved issues arising from the case shall be submitted to arbitration if the person so requests. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph."

To improve the legal protection of their taxpayers a number of countries have re-negotiated their older treaties and have added arbitration clauses. Such treaties contain a provision which either requires the contracting states, or offers them the

7 United Nations, *Administration of Double Tax Treaties* at 167.

8 OECD on *Improving the Process for Resolving International Tax Disputes* (2004). Available at: http://www.oecd.org/tax/treaties/33629447.pdf. The 2004 Report included 31 proposals to improve the resolution of tax treaty disputes through the MAP.

9 United Nations, *Administration of Double Tax Treaties* at 169.

opportunity, to enter into a binding arbitration process. There may or may not be a time limit whereby if agreement has not been reached, the arbitration process is triggered. The 2008 version of the OECD MTC puts this at two years.[10]

It should be noted though, that the majority of the treaties concluded by OECD member countries since 2008, do not contain an Article 25(5) arbitration provision.[11] Some of the reasons for this could be because of a footnote to the commentary on Article 25(5) which states that due to the difficulties in some countries regarding the interrelationship between MAP decisions and domestic court decisions, countries are free to exclude arbitration from their treaties. The footnotes states:

> "in some States, national law, policy or administrative considerations may not allow or justify the type of dispute resolution envisaged under this paragraph. In addition, some States may only wish to include this paragraph in treaties with certain States. For these reasons, the paragraph should only be included in the Convention where each State concludes that it would be appropriate to do so. However, other States may be able to agree to remove from the paragraph the condition that issues may not be submitted to arbitration if a decision on these issues has already been rendered by one of their courts or administrative tribunals".

The other matter is that although some countries' domestic law may give effect to MAP decisions even if they are contrary to domestic court decisions, in other countries, domestic law does not permit the MAP decision to override a court decision; which may make such states incapable of effectively implementing arbitration.[12] Paragraph 65 of the Commentary on Article 25 explains that:

> "It is recognised, however, that in some States, national law, policy or administrative considerations may not allow or justify the type of arbitration process provided for in the paragraph. For example, there may be constitutional barriers preventing arbitrators from deciding tax issues. In addition, some countries may only be in a position to include this paragraph in treaties with particular States. For these reasons, the paragraph should only be included in the Convention where each State concludes that the process is capable of effective implementation".

The OECD recommends that even where Contracting States have not included an arbitration clause in their Convention, it is still possible for them to do so (if they so wish) to implement an arbitration process for general application or to deal with a specific case, by mutual agreement.[13]

2.2 THE PROCEDURE FOR ARBITRATION

Paragraph 68 of the Commentary on Article 25(5) states that the taxpayer can request arbitration of unresolved issues in all cases dealt with under MAP on the

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10 Angharad Miller and Lynne Oats *Principles of International Taxation* 4th edition (2014) in chapter 7

11 OECD "Tax Conventions and Related Questions: Obstacles That Prevent Countries From Resolving Treaty Related Disputes Under the Mutual Agreement Procedure" in para 31.

12 Para 9 of the Commentary on art 25 of the OECD MTC reproduced in para 9 of the Commentary on Article 25 of the UN MTC.

13 Paragrah 69 of the Commentary on article 25(5) of the OECD MTC.

basis that the actions of one or both of the Contracting States have resulted in taxation not in accordance with the treaty. In terms of paragraph 63 of the Commentary on Article 25(5), the arbitration process is not dependent on a prior authorization by the competent authorities: once the requisite procedural requirements have been met, the unresolved issues that prevent the conclusion of a MAP must be submitted to arbitration. Recourse to arbitration is not automatic; the person who presented the case may prefer to wait beyond the end of the two-year period, for example, to allow the competent authorities more time to resolve the case under article 25(2).[14]

The OECD MTC sets out a "Sample Mutual Agreement on Arbitration", in terms of which:[15] an aggrieved taxpayer must make "request for arbitration" in writing regarding the unresolved issues arising from a mutual agreement case and send the same to one of the competent authorities accompanied by a written statement that no decision on the case has been rendered by a court or administrative tribunal of the States. Within 10 days of the receipt of the request, the competent authority who received it shall send a copy of the request and the accompanying statements to the other competent authority. [16] Within three months after the request for arbitration from the taxpayer has been received by both competent authorities, the competent authorities shall agree on the questions to be resolved by the arbitration panel and communicate them in writing to the person who made the request for arbitration. This is what constitutes the "Terms of Reference" for the case.[17] There after each of the competent authorities appoints one arbitrator. Within two months of the latter appointment, the appointed arbitrators are expected to appoint a third arbitrator who functions as the Chair, and makes the final decision. If any appointment is not made within the required time period, the arbitrator(s) not yet appointed have to be appointed by the Director of the OECD Centre for Tax Policy and Administration within 10 days of receiving a request to that effect from the person who made the request for arbitration.[18] Any person, including a government official of a Contracting State, may be appointed as an arbitrator, unless that person has been involved in prior stages of the case that results in the arbitration process.[19]

2.3 THE ARBITRATION DECISION

The arbitration panel does not itself formally dispose of the issue. Instead, the Competent Authorities are obliged under the treaty to dispose of the issue in conformity with the arbitration panel's decision. The decision is usually based on a

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14 Par 70 of the Commentary on article 25(5) of the OECD MTC.
15 OECD *Sample Mutual Agreement on Arbitration* in the commentary on article 25 of the OECD MTC par 1.
16 Ibid.
17 OECD, *Sample Mutual Agreement on Arbitration* supra n 86 par 3.
18 OECD, *Sample Mutual Agreement on Arbitration* supra n 86 para 5.
19 OECD, *Sample Mutual Agreement on Arbitration* supra n 86 par 7.

reasoned opinion based on the arbitration panel assessment with the intention of a cohesive approach to treaty interpretation.

Since the treaty is an agreement between the contracting states, the arbitration decision is binding on both contracting states and shall be implemented notwithstanding the time limits in the domestic laws of the contracting states. The decision is final with no possibility for review or appeal by any board. This matter has been a major source of concern and a reason for some governments' general reluctance towards arbitration. This is unlike the case of bilateral investment agreements where arbitration proceedings are subject to scrutiny for example by the International Court of Arbitration.[20]

The decision of the MAP arbitration panel is however not necessarily binding on the aggrieved person who can still approach the domestic courts to settle the issue.[21] It should be noted that where the arbitrators jointly agree on a different solution, the UN Model also allows the Competent Authorities to depart from the arbitral award within 6 months after it is rendered. This is not possible under the OECD Model where the Competent Authorities are bound to implement the arbitral award.[22]

2.4 FORMS OF ARBITRATION DECISIONS

As indicated above, the generally applicable rule is that the arbitrators must give a reasoned opinion for their decision. Under the OECD Sample Mutual Agreement on Arbitration, this reasoned approach is the default approach. However both the OECD and the UN Sample Mutual Agreements on Arbitration, allow the use of "short form" arbitration. Basically under the "short form" approach, to avoid costs of arbitration and to speed up the process, each competent authority submits an offer to settle the dispute (its desired result) and the arbitrator simply picks one or the other of the two options without any reasoned opinion justifying the result. [23] The arbitrators are given only a limited time to make the decision - the one which is considered more in accordance with the treaty. The arbitrators do not give a fully written explanation of the decision but only "short reasons" explaining the choice, and the outcome is not made public.[24]

20 http://www.iccwbo.org/products-and-services/arbitration-and-adr/arbitration/icc-arbitration-process/award-and-award-scrutiny/

21 Oliver and Honiball *International Tax*, p. 475.

22 Compare Article 25.5 (Alternative B) UN Model with Article 25 OECD Model. In both Models, the taxpayer affected by the decision may reject the decision also.

23 UN "Handbook on Selected Issues in Administration of Tax treaties for Developing Countries" (2013) at 331.

24 Paragraph 6 of the UN Sample Agreement – see Annex to the Commentary on Article 25 (5) (alternative B) of the United Nations Model Convention

In the UN Sample Mutual Agreement on Arbitration, "short form" arbitration is the default or basic arbitration approach applied.[25] The United Nations Committee of Experts on International Cooperation in Tax Matters selected this approach as it is quicker and less costly. However, the Terms of Reference may allow the competent authorities to select an "independent opinion" if they wish. The "independent opinion" approach has the advantage of providing a fuller explanation of the decision and gives the possibility for the decision being a guide to the settlement of future cases involving the same issue. If an independent opinion approach is taken, it would is possible, with the approval of both the competent authorities and the taxpayer to publish a redacted version of the decision, which would help to resolve similar cases in the future. [26]

2.5 CONCERNS ABOUT TAX ARBITRAL PROCEEDINGS

2.5.1 CONFIDENTIALITY OF TAX ARBITRAL PROCEEDINGS

Tax arbitral proceedings are currently confidential and so there are no publicly available outcomes to MAP. The secrecy of the MAP is based on the fact that businesses do not want to make their tax strategies public and that confidential proceedings allow for more flexibility for achieving a mutually acceptable result between governments without any external influences. The secrecy of MAP makes it difficult to draw from the experience or to monitor the fairness and effectiveness of the arbitration systemically. The emphasis on confidentiality over transparency is a concern for many countries as it makes it difficult to develop confidence in the system since taxpayers cannot ascertain if the same decision would be applied in other similar cases. This mechanism is a far cry from the clear procedure for arbitration under the World Trade Organisation (WTO), where there are institutional provisions in place to assist developing countries in cases involving them[27] and to ensure consistency in approaches of panels,[28] as well as an appeal system to an Appellate Body.[29] The other concern is that the OECD Model provides limited guidance in the selection of an arbitrator whereas arbitration under the WTO, provides a list of arbitrators who are appointed according to certain criteria. The list

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25 Paragraph 6 of the UN Sample Agreement – see Annex to the Commentary on Article 25 (5) (alternative B) of the United Nations Model Convention

26 UN "Handbook on Selected Issues in Administration of Tax treaties for Developing Countries" (2013) at 336.

27 WTO "Developing Countries in WTO Dispute Settlement". Available at https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c11s2p2_e.htm accessed 21 October 2015.

28 WTO "The Panels". Available at https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c3s3p1_e.htm accessed 21 October 2015.

29 WTO "The Appellate Body". Available at https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c3s4p1_e.htm accessed 21 October 2015.

of arbitrators often includes information about the number of times an arbitrator has served in other disputes and the countries involved.

2.5.2 LACK OF EXPERIENCE

Many countries having limited experience with mutual agreement procedures could have difficulties to determine the consequences of adding arbitration in a mutual agreement procedure. The lack of expertise in many developing countries with mutual agreement procedures implies that arbitration would be unfair to them when the dispute occurs with more experienced countries.

For a country to expect a positive result out of MAP, it ought to have signed a tax treaty that protects its interest. The ability to negotiate favourable provisions depends a lot on the treaty negotiating power of the relevant country. In general, developed countries are better skilled in negotiating tax treaties than developing countries.[30] Because in treaty negotiations with developed countries the powers are not balanced and developing countries tend to be price takers, they tend to negotiate treaty provisions that are not in their favour but rather reflect the position of the other contracting state.[31] The interests of countries, which are already in the balance in their tax treaties cannot be safeguarded by private arbitrators; nor can arbitrators be expected to make up for the lack of expertise in many developing countries.

2.5.3 NEUTRALITY OF AND EXPERIENCE OF ARBITRATORS

MAP does not guarantee the neutrality and independence of arbitrators. There are very experienced arbitrators, most of whom are from developed countries who may not be considered impartial if the case involves their own country.

2.5.4 CONCERNS ABOUT TAX SOVEREIGNTY

There are also concerns that mandatory binding arbitration impacts on "tax sovereignty". Countries are generally considered to be sovereign in their tax affairs. When countries sign tax treaties to prevent double taxation, their tax sovereignty may be limited by the treaty distributive rules that allocate taxing rights to tax the relevant income to either residence or source states. Committing to arbitration is often considered as going beyond what the treaty intended, since it requires the countries to agree to a panel of arbitrators who may be civil servants of the contracting states that are given wide discretionary powers to resolve a treaty matter.

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30 PWC, EuropeAID 'Implementing the Tax and Development Policy Agenda: Final Report on Transfer Pricing and Developing Countries' (2011) at 21.

31 Festus Akunobela "The Relevance of the OECD and UN Model Conventions and their Commentaries for the interpretation of Ugandan Tax Treaties " p 1089, Chapter 35 in M Lang, P Pistone, J Schuch and C Staringer *The Impact of the OECD and UN Model Tax Conventions on Bilateral Tax Treaties* (Cambridge University Press, 2012) at 1075.

Giving too much power to individuals who are third parties to decide treaty matters, without the possibility of review or challenging such decisions would impact on the states sovereignty.

2.5.5 THE COSTS OF ARBITRATION

The other reason why countries are hesitant towards arbitration is that it can also be very costly. Costs can include: costs of hiring arbitrators, facilities, hiring external advisors and counsel; costs of setting up meetings for arbitration proceedings; travelling; as well as costs for translating and preparing documents. Countries are also expected to pay their share of the salaries of arbitrators, the organization costs for the tribunal as well as the costs of representation. If there is unfamiliarity with arbitration some outside expertise might need to be brought in as well.

It is important that cost issues do not distort outcomes under the MAP against those countries least able to bear them. There is a concern that Competent Authorities from developing countries, especially the least developed, might effectively be "forced" to agree to an outcome proposed by the other Competent Authorities involved in the MAP not because they are convinced of the arguments put, but to avoid further arbitration costs. Such a situation would put to question the validity of the arbitration process, since the economic power of the relevant countries would influence the outcome of the arbitration case.

2.5.6 CONCERNS ABOUT "SHORT FORM ARBITRATION"

As explained above, a MAP decision is ideally using the approach of a reasoned decision. This approach has the advantage of providing a fuller explanation of the decision and gives the possibility for the decision being a guide to the settlement of future cases involving the same issue.[32]

The MTCs however allow the use of short form arbitration (as an alternative approach under the OECD MTC and as the main approach in the UN MTC). However, there are concerns about the short form or "baseball arbitration", [33] in terms of which, to avoid costs of arbitration and to speed up the process, the competent authorities just submit an offer to settle the dispute and the arbitrator or panel of arbitrators is allowed to choose between the two proposals - the one which is considered more in accordance with the treaty. In this form of arbitration there is generally no reasoned written decision required, and the outcome is not made public, thus causing transparency concerns. In such arbitrations cases the winning country gets the tax revenue and the other loses. This can be exemplified by the

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[32] UN "Handbook on Selected Issues in Administration of Tax treaties for Developing Countries" (2013) at 336.

[33] This type of procedure is sometimes known as baseball arbitration, due to the fact that the salaries of US major league baseball players have been negotiated in this manner.

situation between the USA and Canada, in which the US Internal Revenue Service has won three of the binding arbitration decisions and Canada none.[34] Since some transfer pricing cases have billions of dollars of tax at stake, countries are concerned at the loss of revenue based on such decisions. Although the short form arbitration can offer more certainty of speedy and cost effective resolution in a particular case, it does not necessarily lead to an outcome that is in accordance with the treaty as it only allows the arbitrators to choose between one of the solutions submitted. The secrecy involved, fosters legal uncertainty as the decisions are not reasoned or published anywhere. There are concerns that decisions reached may favour those with the most experience in putting a compelling and professional looking argument over those with better underlying arguments that are nevertheless not as well presented.

3 VIEWS ON MAP GENERALLY

The above factors have affected the effectiveness of MAP in resolving treaty disputes. Treaties are designed to prevent double taxation, and many have an article for MAP for resolving issues around double taxation. But law and treaties only pronounce principles. The practical prevention of double taxation is in the hands of individual auditors and revenue administrations that decide the extent to which they wish to enforce the policies and arbitration clauses in the treaties.[35] Even the best designed laws and regulations can't prevent double taxation without effective means of dispute resolution. The issue with double taxation is not how the laws are written but how they are enforced by various governments.[36] Laws and bilateral treaties alone cannot prevent double taxation. The lack of effective means of dispute resolution is where multilateral efforts appear to be breaking down.[37]

According to the OECD statistics, the MAP caseload is rising exponentially.[38] In response, the OECD formed the Mutual Agreement Procedures Forum (MAP Forum)[39] - a meeting of competent authorities from 25 countries, which focuses on empowering competent authorities to ensure they have adequate resources, and to provide oversight over the individuals negotiating the settlements under the MAP.[40]

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[34] P Temple-West, Reuters "International Arbitration for Tax Disputes, "Baseball" Style". Available at http://www.reuters.com/article/2012/11/25/us-usa-tax-arbitration-idUSBRE8AO06T20121125 accessed 26 march 2015.

[35] M Herzfeld "Beyond BEPS: The Problem of Double Taxation" *Tax Analyst* 10 February 2014 at 1.

[36] Ibid.

[37] Ibid.

[38] OECD "Mutual Agreement Procedure Statistics" (2012). Available at http://www.oecd.org/ctp/dispute/mapstatistics2012.htm.

[39] OECD Forum on Tax Administration "Mutual Agreement Procedure Forum". Available at hyyp://www.oecd.org/site/ctpfta/ftaworkprogramme201213.htm

[40] M Herzfeld "Beyond BEPS: The Problem of Double Taxation" Tax Analyst (10 February 2014) at 1.

4 PREVIOUS OECD WORK ON MAP

The OECD has over the years carried out some work to ensure the effectiveness of MAP.

- On 27 July 2004, the OECD Committee on Fiscal Affairs released a progress report on its work on improving the resolution of cross-border tax disputes. The report was titled "*Improving the Process for Resolving International Tax Disputes*".
- On 1 February 2005, the OECD came up with "*Proposals for Improving Mechanisms for the Resolution of Tax Treaty Disputes*" was released as a public discussion draft. It included various draft changes to the OECD Model Tax Convention, dealing primarily with the addition of an arbitration process to solve disagreements arising in the course of a mutual agreement procedure, as well as a proposal for developing an online Manual on Effective Mutual Agreement Procedure[41]
- On 30 January 2007, the OECD issued a report on "Improving the resolution of tax treaty disputes"
- In 2007 the OECD developed a "Manual on effective Mutual Agreement Procedures" ("MEMAP") which contains basic information on the operation of MAP and best practices of MAP.
- In the 2012 OECD Report on dispute resolution, [42] the OECD noted that many of the obstacles to an effective MAP are of a procedural, practical or administrative nature, relating to issues such as lack of resource, empowerment of competent authorities to reach principled case resolutions and the development of competent authority relationships based on mutual trust.
- At the January 2012 OECD Roundtable on Dispute Resolution[43] practitioners raised the question of impediments to access the MAP, the ineffectiveness of the MAP in multilateral cases, the limited number of arbitration provisions included in tax treaties and MAP procedural issues.[44] The OECD recognised that effective and efficient dispute resolution mechanisms are of crucial importance for the functioning of tax treaties and that in the current international environment improving the functioning of MAP procedures, including through inclusion of arbitration as an ultimate remedy, has gained importance and urgency.[45]

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41 OECD Report: Improving the resolution of tax treaty disputes".

42 OECD Working Party 1 'Tax Conventions and Related Questions: Obstacles That Prevent Countries From Resolving Treaty Related Disputes Under the Mutual Agreement Procedure' (16 September 2013) para 16.

43 OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" para 7.

44 OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 7.

45 OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 9.

5 OECD 2013 BEPS REPORT: ACTION 14

In July 2013 OECD published its "Action Plan on Base Erosion and Profit shifting", containing 15 Action Points. In Action Point 14: "Make dispute resolution mechanisms more effective," the OECD noted that actions to counter BEPS must be complemented with actions to improving the effectiveness of MAP so as to ensure certainty and predictability for business.[46] Action 14 recognises that the BEPS project will change the face of international taxation. Currently multinational enterprises are not only protected from double taxation by tax treaties, but they can also design their own strategy to prevent double taxation and can even realise low or no taxation through careful tax planning, by manipulating gaps in the domestic tax systems of the tax jurisdictions in which they are involved. When these strategies are dismantled through the introduction of BEPS measures, the pressure on tax treaties to resolve double taxation will rise. Since it is difficult, if not impossible, to design rules that are open to only one interpretation, it is very likely that the pressure on the dispute resolution mechanisms that are included in tax treaties will grow significantly.[47]

Action 14 of the 2013 OECD BEPS report called on countries to:

- make dispute resolution mechanisms more effective;
- develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP; such include:
  - the absence of arbitration provisions in most treaties; and
  - the fact that access to MAP and arbitration may be denied in certain cases.[48]

Under Action 14, the OECD undertook to work on developing solutions that address obstacles and prevent countries from solving treaty-related disputes under the MAP. It also considered supplementing the existing MAP provisions in tax treaties with a mandatory and binding arbitration provision. [49]

BEPS Action Plan Action 14 aims to improve treaty-related dispute resolution under MAPs, including the absence of arbitration provisions in most treaties and the denial of access to MAPs and arbitration in some cases. If the business community does not publicly support Action 14, the resulting double taxation problems arising from a lack of multilateral coordination on enforcement of cross-border disputes could make current concerns over stateless income appear insignificant.[50]

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46 OECD "Action Plan on Base Erosion and Profit Shifting" (2013) at 23
47 OECD "Obstacles That Prevent Countries from Resolving Treaty Related Disputes" in para 6.
48 OECD "Action Plan on Base Erosion and Profit Shifting" (2013) at 23.
49 OECD "Action Plan on Base Erosion and Profit Shifting" (2013) at 24.
50 Ibid.

5.1 FACTORS IDENTIFIED BY THE OECD THAT PRESENT OBSTACLES TO MAP

In September 2013, OECD Working Party 1 released a report on "Obstacles that Prevent Countries from Resolving Treaty-related Disputes under the Mutual Agreement Procedure".[51] The Report identified the following obstacles that may prevent countries from resolving treaty-related disputes through the MAP:

5.1.1 PRACTICAL AND ADMINISTRATIVE ISSUES

The OECD noted that many of the obstacles to an effective MAP are of a practical or administrative nature (e.g. resource issues, empowerment of competent authorities to reach principled case resolutions, development of competent authority relationships based on mutual trust, etc.). Addressing these challenges would require changes to the OECD Model Tax Convention, changes to the OECD "Manual on Effective Mutual Agreement Procedures" (MEMAP) [52] as well as changes to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the Transfer Pricing Guidelines) (in particular Chapter IV, "Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes").[53]

5.1.2 UNILATERAL DENIAL OF ACCESS TO MAP

The OECD noted that unilateral denial of access to the MAP has been a longstanding concern of OECD work to improve the effectiveness of the MAP. This was pointed out in the 2004 OECD report on "Improving the Process for Resolving International Tax Disputes"[54] referred to above, in which it was explained that notwithstanding Article 25(1), in some cases countries refuse to enter into MAP where they consider that the relevant taxpayer has engaged in fraud or certain kinds of tax avoidance in relation to the case for which MAP is sought.[55] Concerns have for instance been raised about countries like India which deny under domestic law what is available under treaty. Although Indian legislation is becoming more aligned with international norms, these changes may not always be implemented by revenue officers.[56]

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[51] OECD "Obstacles that Prevent Countries from Resolving Treaty Related Disputes" in para 4.

[52] OECD "Manual on Effective Mutual Agreement Procedures" (2007) Available at http://www.oecd.org/ctp/38061910.pdf accessed 16 May 2014.

[53] OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 17.

[54] OECD on *Improving the Process for Resolving International Tax Disputes* (2004). Available at: http://www.oecd.org/tax/treaties/33629447.pdf. The 2004 Report included 31 proposals to improve the resolution of tax treaty disputes through the MAP.

[55] OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 19.

[56] M Herzfeld "Beyond BEPS: The Problem of Double Taxation" *Tax Analyst* 10 February 2014 at 1.

To address this issue, the 2004 Report proposed that: "the circumstances in which a taxpayer should be denied access to the MAP would be analysed together with a discussion of possible appropriate practices in this regard, taking into account the differing domestic law circumstances in different countries".[57] This proposal resulted in the addition of paragraphs 26 to 29 to the Commentary on Article 25 in 2008, which explains that the fact that a charge of tax is made under an avoidance provision of domestic law does not justify a denial of access to the mutual agreement procedure. This is in line with article 27 of the Vienna Convention on the Law of Treaties which requires that justification for a denial of MAP access be found in the terms of the treaty itself, as interpreted in accordance with accepted principles of tax treaty interpretation.[58]

The OECD notes that unilateral denial of access to the MAP may be particularly problematic in the context of the work on BEPS, which, may be expected to lead to the development of a broad range of domestic law and treaty-based anti-abuse rules, many of which may be novel and/or susceptible to conflicting interpretations. The OECD Action Plan for instance indicates that the adoption of special measures in the area of transfer pricing, that go beyond the arm's length principle with respect to intangible assets (such as the proposal to use profit-splits), risk and over-capitalisation, may lead to higher risks of double taxation. [59]

The OECD committed to work on clearly articulating the circumstances under which a State – in a manner consistent with its treaty obligations and the principles of treaty interpretation set forth in the Vienna Convention on the Law of Treaties – may justifiably deny access to the MAP.[60]

5.1.3 THE CURRENT LACK OF AN ARTICLE 25(5) ARBITRATION PROVISION IN THE MAJORITY OF THE TREATIES

As explained above, the 2004 OECD report on "Improving the Process for Resolving International Tax Disputes"[61] proposed the development of a binding arbitration process to resolve disagreements arising in the course of a MAP case. This culminated in the addition of the arbitration provision (Article 5(5)), of the OECD an integral part of the OECD MAP process. However the majority of the treaties concluded by OECD member countries since 2005, do not contain an Article 25(5) arbitration provision. [62] As explained above, one of the reasons why countries may not have included arbitration in their tax treaties could have been the fact that article

57 OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 19.
58 OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 21.
59 OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 22.
60 OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 24.
61 OECD on *Improving the Process for Resolving International Tax Disputes* (2004).
62 OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 31.

25 of the OECD Model contains a footnote stating that countries are free to exclude arbitration from their treaties. The OECD committed to examine:

- Whether and to what extent the views reflected in the footnote to article 25(5) still reflect the position of OECD countries. As States have become more familiar with arbitration, the considerations reflected in the footnote and Commentary may be no longer seen as a hindrance to including arbitration provisions in tax treaties; [63]
- The reasons why OECD member countries have failed to include mandatory binding arbitration provisions in their recent tax treaties; [64]
- The MAP cases to be covered by arbitration. Article 25(5) currently provides that cases eligible for arbitration are cases arising under Article 25(1) which are based on the claim that the actions of one or both of the Contracting States have resulted in taxation not in accordance with the Convention; [65]
- The circumstances under which States may, consistent with their obligations under Article 25 of the OECD Model and international law, justifiably deny a taxpayer access to arbitration with respect to an Article 25(1).[66] These would result in clarifications and/or amendments to paragraph 5 of Article 25; [67] and
- Appropriately consider the best way of ensuring that arbitration is included in bilateral treaties, which would include consideration of whether an arbitration provision should be included in the multilateral instrument that is proposed to be developed pursuant to Action 15 of the Action Plan. [68]

The OECD notes that in developing instruments and approaches to address obstacles to MAP, the differences in the dynamics between MAP with and MAP without arbitration need to be recognised. As access to arbitration automatically means that the double taxation will be resolved, it may be warranted to more carefully and clearly define the circumstances in which access to MAP including arbitration is permitted. It was also necessary to identify types of MAP cases where governments do not want to unconditionally commit to providing a resolution with respect to the taxation not in accordance with the Convention. For access to the MAP where an arbitration procedure is excluded, more unconditional access to MAP may be warranted, as competent authorities only need to endeavour to reach a solution. [69]

On 18 December 2014 the OECD released a Public Discussion Draft on Action 14, this culminated in the final report on MAP in 2015 (which is summarized below).

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[63] OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 34.
[64] OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 35.
[65] OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes Under the Mutual Agreement Procedure" in para 36.
[66] OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 36.
[67] OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 37.
[68] OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 38.
[69] OECD "Obstacles That Prevent Countries From Resolving Treaty Related Disputes" in para 10.

6 SUMMARY OF THE OECD REPORT IN ACTION 14: MAKING DISPUTE RESOLUTION MECHANISMS MORE EFFECTIVE, 2015 FINAL REPORT

The OECD Final Report on Action 14 reiterates that the actions to counter BEPS must be complemented with actions that ensure certainty and predictability for business and that improving the effectiveness of MAP in resolving treaty-related disputes, is an integral component of the work on BEPS issues.[70] The Report notes that the interpretation and application of novel rules resulting from the BEPS project could introduce elements of uncertainty that should be minimised as much as possible.[71] In response to Action 14 which requires that countries make dispute resolution mechanisms more effective, to develop solutions to address obstacles to MAP, to address the absence of arbitration in most treaties and the denial of access to MAP in certain cases; the OECD issued its final report on “Making Dispute Resolution Mechanisms More Effective” in 2015. This report reflects:

- A commitment by countries to implement a minimum standard on dispute resolution, consisting of specific measures to remove obstacles to an effective and efficient MAP.
- Agreement by countries to establish a peer-based monitoring mechanism to ensure that the commitments contained in the minimum standard are effectively satisfied. [72]

The minimum standard constitutes specific measures that countries will take to ensure that they resolve treaty-related disputes in a timely, effective and efficient manner. The elements of the minimum standard have been formulated to reflect clear, objective criteria that will be susceptible to assessment and review in the monitoring process. [73] The elements of the minimum standard are intended to fulfil three general objectives:

- Countries should ensure that treaty obligations related to the MAP are fully implemented in good faith and that MAP cases are resolved in a timely manner;
- Countries should ensure that administrative processes promote the prevention and timely resolution of treaty-related disputes; and
- Countries should ensure that taxpayers that meet the requirements of Article 25(1) can access MAP. [74]

The specific measures that are part of the minimum standard will result in certain changes to the OECD Model Tax Convention to be drafted as part of the next update

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[70] OECD/G20 2015 Final Report on Action 14 in para 2.
[71] OECD/G20 2015 Final Report on Action 14 in para 2.
[72] OECD/G20 2015 Final Report on Action 14 in para 3.
[73] OECD/G20 2015 Final Report on Action 14 in para 6.
[74] OECD/G20 2015 Final Report on Action 14 in para 4.

to the OECD Model Tax Convention in order to reflect the conclusions of this Report.[75]

6.1 THE ELEMENTS OF A MINIMUM STANDARD TO ENSURE TIMELY, EFFECTIVE AND EFFICIENT RESOLUTION OF TREATY-RELATED DISPUTES

I) <u>Countries should ensure that treaty obligations related to MAP are fully implemented in good faith and that MAP cases are resolved in a timely manner:</u>

Since MAP forms an integral and essential part of the obligations assumed by a Contracting State in entering in to a tax treaty,[76] the OECD recommends that:

a) **Countries should include Articles (25)(1) – (3) in their tax treaties. They should provide access to MAP in transfer pricing cases and implement the resulting MAP (e.g. by making appropriate adjustments to the tax assessed):**
   - Countries should thus provide access to MAP in transfer pricing cases Failure to grant MAP access a view to eliminating the economic double taxation that results from transfer pricing adjustments will frustrate a primary objective of tax treaties.[77]
   - Countries should provide access to MAP with regards to article 9(2) if their domestic law enables them to provide for a corresponding adjustment. The competent authorities should consult with each other to determine the appropriate amount of that corresponding adjustment with the aim of avoiding double taxation.[78]

b) **Countries should provide** MAP **access in cases where there is a disagreement between the taxpayer and the tax authorities making the adjustment with respect to whether the conditions for the application of a treaty anti-abuse provision have been met or as to whether the application of a domestic law anti-abuse provision is in conflict with the provisions of a treaty:**
   - Paragraph 26 of the Commentary on Article 25, provides that in the absence of a special provision, there is no general rule denying MAP access in cases of perceived abuse.
   - In cases of treaty abuse, paragraphs 9.1 to 9.5 of the Commentary on Article 1 states that there is an obligation to provide MAP access in cases of abuse. Paragraph 9.5 provides that treaty benefits may be denied through the application of an anti-abuse provision to ensure

[75] OECD/G20 2015 Final Report on Action 14 in para 5.
[76] OECD/G20 2015 Final Report on Action 14 in para 9.
[77] OECD/G20 2015 Final Report on Action 14 in para 11.
[78] OECD/G20 2015 Final Report on Action 14 in para 13.

treaty benefits are gained contrary to the object and purpose of the relevant treaty provisions. For example, Action 6 will ensure that tax treaties incorporate general anti-abuse rule based on the principal purposes test or "PPT" rule, according to which the benefits of a tax treaty should not be available where one of the principal purposes of arrangements or transactions is to secure a benefit under a tax treaty and obtaining that benefit in these circumstances would be contrary to the object and purpose of the relevant provisions of the tax treaty. The interpretation and/or application of that rule would clearly fall within the scope of the MAP. [79]

c) **Countries should commit to a timely resolution of MAP cases and they should commit to resolve MAP cases within an average timeframe of 24 months (depending on the complexity of each case). Countries' progress toward meeting that target will be periodically reviewed on the basis of the statistics prepared in accordance with the agreed reporting framework:**

- This reporting framework will include agreed milestones for the initiation and conclusion/closing of a MAP case, as well as for other relevant stages of the MAP process.
- Work to develop the reporting framework will seek to establish agreed target timeframes for the different stages of the MAP process. [80]

d) **Countries should enhance their competent authority relationships and work collectively to improve the effectiveness of the** MAP **by becoming members of the Forum on Tax** A**dministration** MAP **Forum** (FTA MAP Forum):

- The FTA Forum, a subsidiary body of the OECD Committee on Fiscal Affairs, currently brings together Commissioners from 46 countries to develop on an equal footing a global response to tax administration issues in a collaborative fashion.
- The FTA MAP Forum is a forum of FTA participant country competent authorities created to deliberate on general matters affecting all participants' MAP programmes that has developed a multilateral strategic plan to collectively improve the effectiveness of the MAP in order to meet the needs of both governments and taxpayers and so assure the critical role of the MAP in the global tax environment. [81]

e) **Countries should provide timely and complete reporting of** MAP **statistics, pursuant to an agreed reporting framework to be developed in co-ordination with the FTA MAP Forum:**

[79] OECD/G20 2015 Final Report on Action 14 in para 11.
[80] OECD/G20 2015 Final Report on Action 14 in para 18.
[81] OECD/G20 2015 Final Report on Action 14 in para 19.

- Since 2006, the OECD has collected and published MAP statistics from OECD member countries and from non-OECD economies that agree to provide these statistics.
- These statistics provide transparency with respect to each reporting economies' MAP programme as well as a comprehensive picture of the overall state of the MAP in all of the economies reporting statistics.
- In the context of the work on Action 14, MAP statistics should be expected to provide a tangible measure to evaluate the effects of the implementation of the minimum standard and an important component of the monitoring mechanism.
- Countries should accordingly provide a timely and complete reporting of MAP statistics, pursuant to an agreed reporting framework that will be developed in co-ordination with the FTA MAP Forum.
- The reporting framework will include agreed milestones for the initiation and conclusion/closing of a MAP case, as well as for other relevant stages of the MAP process. [82]

f) Countries should commit to have their compliance with the minimum standard reviewed by their peers in the context of the FTA MAP Forum:

- The OECD recommends that countries should become members of the FTA MAP Forum and commit to have their compliance with the minimum standard reviewed by their peers through an agreed monitoring mechanism that will be developed in co-ordination with the FTA MAP Forum.
- Such monitoring is essential to ensure the meaningful implementation of the minimum standard. [83]

g) Countries should provide transparency with respect to their positions on MAP arbitration:

- Mandatory binding MAP arbitration has been included in a number of bilateral treaties following its introduction in Article 25(5) of the OECD MTC in 2008. However a footnote to paragraph 5 notes that national law, policy or administrative considerations may not allow or justify this type of dispute resolution and that States should only include the provision in the Convention where they conclude that it would be appropriate to do so. [84]
- Based on the footnote it is unnecessary for countries to enter reservations (in the case of OECD member countries) or positions (in the case of non-OECD economies) on the provision. As a consequence,

[82] OECD/G20 2015 Final Report on Action 14 in para 20.
[83] OECD/G20 2015 Final Report on Action 14 in para 21.
[84] Based on the factors described in paragraph 65 of the Commentary on Article 25. See OECD/G20 2015 Final Report on Action 14 in para 22.

however, there is a lack of transparency as to countries' positions with respect to MAP arbitration. [85]

- In order to provide transparency with respect to country positions on MAP arbitration, the OECD notes that the above mentioned footnote will be deleted and paragraph 65 of the Commentary on Article 25 will be appropriately amended when the OECD MTC next updated to include in particular suitable alternative provisions for those countries that prefer to limit the scope of MAP arbitration to an appropriately defined subset of MAP cases. [86]

II) <u>Countries should ensure that administrative processes promote the prevention and timely resolution of treaty-related disputes:</u>

- The OECD notes that appropriate administrative processes and practices are important to ensure an environment in which competent authorities are able to fully and effectively carry out their mandate to take an objective view of treaty provisions and apply them in a fair and consistent manner to the facts and circumstances of each taxpayer's specific case.
- The elements of the minimum standard are intended to address a number of different obstacles to the prevention and timely resolution of disputes through the MAP that are related to the internal operations of a tax administration and the competent authority function, as well as to the transparency of procedures to use the MAP and to the approaches used by competent authorities to address proactively potential disputes. [87]

a) Countries should publish rules, guidelines and procedures to access and use the MAP and take appropriate measures to make such information available to taxpayers:

- Countries should ensure that their MAP guidance is clear and easily accessible to the public (*e.g.* made available on the websites of the tax administration and/or ministry of finance). This should include guidance on how taxpayers may make requests for competent authority assistance.[88]

b) To promote the transparency and dissemination of the MAP programme, countries should publish their country MAP profiles on a shared public platform (pursuant to an agreed template to be developed in co-ordination with the FTA MAP Forum).

- A "country MAP profile" is a document providing competent authority contact details, links to domestic MAP guidelines and other useful country-specific information regarding the MAP process.

[85] OECD/G20 2015 Final Report on Action 14 in para 23.
[86] OECD/G20 2015 Final Report on Action 14 in para 23.
[87] OECD/G20 2015 Final Report on Action 14 in para 24.
[88] OECD/G20 2015 Final Report on Action 14 in para 25.

- The OECD will develop a template for the content of the country MAP profiles in co-ordination with the FTA MAP Forum. [89]

c) **Countries should ensure that the staff in charge of MAP processes have the authority to resolve MAP cases in accordance with the terms of the applicable tax treaty, in particular without being dependent on the approval or the direction of the tax administration personnel who made the adjustments at issue or being influenced by considerations of the policy that the country would like to see reflected in future amendments to the treaty:**[90]

d) **Countries should not use performance indicators for their competent authority functions and staff in charge of MAP processes based on the amount of sustained audit adjustments or maintaining tax revenue.**
   - The performance of their competent authority functions and staff in charge of MAP processes should not be evaluated based on the amount of sustained audit adjustments or the maintenance of tax revenue.
   - These internal procedures should instead provide that competent authority functions and staff in charge of MAP processes will be evaluated based on appropriate performance indicators, such as the number of MAP cases resolved; principled and consistent manner of applying to MAP cases of same facts and similarly-situated taxpayers; and time taken to resolve a MAP case (which may vary according to its complexity and that matters not under the control of a competent authority).[91]

e) **Countries should ensure that adequate resources are provided to the MAP function:**
   - Personnel, funding, training and other programme needs should be provided to the MAP function, in order to enable competent authorities to carry out their mandate to resolve cases of taxation not in accordance with the provisions of the Convention in a timely and effective manner. [92]

f) **Countries should clarify in their MAP guidance that audit settlements between tax authorities and taxpayers do not preclude access to MAP:**
   - If countries have an administrative or statutory dispute settlement/resolution process independent from the audit and examination functions and that can only be accessed through a request

[89] OECD/G20 2015 Final Report on Action 14 in para 26.
[90] OECD/G20 2015 Final Report on Action 14 in para 27.
[91] OECD/G20 2015 Final Report on Action 14 in para 28.
[92] OECD/G20 2015 Final Report on Action 14 in para 29.

by the taxpayer, countries may limit access to the MAP with respect to the matters resolved through that process.

- Countries should notify their treaty partners of such administrative or statutory processes and should expressly address the effects of those processes with respect to the MAP in their public guidance on such processes and in their public MAP programme guidance.

g) Countries with bilateral advance pricing arrangement (APA) programmes should provide for the roll-back of APAs in appropriate cases, subject to the applicable time limits (such as statutes of limitation for assessment) where the relevant facts and circumstances in the earlier tax years are the same and subject to the verification of these facts and circumstances on audit.

- Situations may arise in which the issues resolved through an APA are relevant with respect to previous filed tax years not included within the original scope of the APA.
- The "roll-back" of the APA to these previous years may be helpful to prevent or resolve potential transfer pricing disputes, in cases where the relevant facts and circumstances in the earlier tax years are the same.[93]

III) <u>Countries should ensure that taxpayers that meet the requirements of Article 25(1) can access MAP:</u>

Countries should keep their obligation to provide MAP access. The elements of the minimum standard are intended to ensure that taxpayers that meet the requirements of paragraph 1 of Article 25 have access to the mutual agreement procedure.[94]

a) Both competent authorities should be made aware of MAP requests being submitted and should be able to give their views on whether the request is accepted or rejected.

- In order to achieve this, countries should either amend paragraph 1 of Article 25 to permit a request for MAP assistance to be made to the competent authority of either Contracting State, or where a treaty does not permit a MAP request to be made to either Contracting State, implement a bilateral notification or consultation process for cases in which the competent authority to which the MAP case was presented does not consider the taxpayer's objection to be justified (such consultation shall not be interpreted as consultation as to how to resolve the case).[95]

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93 OECD/G20 2015 Final Report on Action 14 in para 33.
94 OECD/G20 2015 Final Report on Action 14 in para 34.
95 OECD/G20 2015 Final Report on Action 14 in para 35.

b) **Countries' published MAP guidance should identify the specific information and documentation that a taxpayer is required to submit with a request for MAP assistance. Countries should not limit access to MAP based on the argument that insufficient information was provided if the taxpayer has provided the required information.**

- The published guidelines and procedures for MAP should include guidance on how taxpayers may make requests for competent authority assistance.
- The FTA MAP Forum will develop guidance on the specific information and documentation required to be submitted with a request for MAP assistance. [96]

c) **Countries should include in their tax treaties the second sentence of Article 25(2) that: "Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States"**

- Countries that cannot include this sentence in their tax treaties should be willing to accept alternative treaty provisions that limit the time during which a Contracting State may make an adjustment pursuant to Article 9(1) or Article 7(2), in order to avoid late adjustments with respect to which MAP relief will not be available.[97]

6.2 MAP BEST PRACTICES RECOMMENDED BY THE OECD

The work on Action 14 also came up with conclusions that reflect the agreement that certain responses to the obstacles that prevent the resolution of treaty-related disputes through MAP are more appropriately presented as best practices. Unlike the elements of the minimum standard, these best practices have a subjective or qualitative character that could not readily be monitored or evaluated or because not all OECD and G20 countries are willing to commit to them at this stage. These best practices relate to the three general objectives of the minimum standard but they are not part of the minimum standard

<u>With respect to minimum standard 1:</u> "Countries should ensure that treaty obligations related to the mutual agreement procedure are fully implemented in good faith and that MAP cases are resolved in a timely manner", the OECD recommends the following best practice.

<u>Best practice 1</u>:

- Countries should include Article 9(2) in their tax treaties.

[96] OECD/G20 2015 Final Report on Action 14 in para 37.
[97] OECD/G20 2015 Final Report on Action 14 in para 43.

- Most countries consider that the economic double taxation resulting from the inclusion of profits of associated enterprises under Article 9(1) is not in accordance with the object and purpose of tax treaties and falls within the scope of the MAP under Article 25.
- Some countries, however, take the position that in the absence of a treaty provision based Article 9(2), they are not obliged to make corresponding adjustments or to grant access to the MAP with respect to the economic double taxation that may otherwise result from a primary transfer pricing adjustment. Such a position frustrates a primary objective of tax treaties – the elimination of double taxation – and prevents bilateral consultation to determine appropriate transfer pricing adjustments.
- The minimum standard will ensure that access to MAP is provided for in such transfer pricing cases. However, it would be more efficient if countries would also have the possibility to provide for corresponding adjustments unilaterally in cases in which they find the objection of the taxpayer to be justified.[98]

With respect to minimum standard 2: "Countries should ensure that administrative processes promote the prevention and timely resolution of treaty-related disputes", the OECD recommends the following best practices.

Best practice 2:

- Countries should have appropriate procedures in place to publish agreements reached pursuant to the authority provided in Article 25(3) "to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention" that affect the application of a treaty to all taxpayers or to a category of taxpayers (rather than to a specific taxpayer's MAP case). Such agreements could provide guidance that would be useful to prevent future disputes and where the competent authorities agree that such publication is consistent with principles of sound tax administration.[99]

Best practice 3:

- Countries should develop the "global awareness" of the audit/examination functions involved in international matters through the delivery of the Forum on Tax Administration's "Global Awareness Training Module" to appropriate personnel. [100]

Best practice 4:

- Countries should implement bilateral APA programmes.[101]

[98] OECD/G20 2015 Final Report on Action 14 in para 44.
[99] OECD/G20 2015 Final Report on Action 14 in para 45.
[100] OECD/G20 2015 Final Report on Action 14 in para 46.
[101] OECD/G20 2015 Final Report on Action 14 in para 48.

Best practice 5:

- Countries should implement appropriate procedures to permit, in certain cases and after an initial tax assessment, taxpayer requests for the multiyear resolution through the MAP of recurring issues with respect to filed tax years, where the relevant facts and circumstances are the same and subject to the verification of such facts and circumstances on audit. Such procedures would remain subject to the requirements of Article 25(1). Thus, a request to resolve an issue with respect to a particular taxable year would only be allowed where the case has been presented within three years of the first notification of the action resulting in taxation not in accordance with the Convention with respect to that taxable year.

With respect to minimum standard *3:* "Countries should ensure that taxpayers that meet the requirements of Article 25(1) can access MAP, the OECD recommends the following best practices:

Best practice 6:

- Countries should take appropriate measures to provide for a suspension of collections procedures during the period a MAP case is pending.
  - o Where the payment of tax is a requirement for MAP access, the taxpayer concerned may face significant financial difficulties: if both Contracting States collect the disputed taxes, double taxation will in fact occur and the resulting cash flow problems may have a substantial impact on a taxpayer's business, for as long as it takes to resolve the MAP case.
  - o A competent authority may also find it more difficult to enter into good faith MAP discussions when it considers that it may likely have to refund taxes already collected.
  - o Countries should accordingly take appropriate measures to provide for a suspension of collections procedures during the period a MAP case is pending.
  - o Such a suspension of collections should be available, at a minimum, under the same conditions as apply to a person pursuing a domestic administrative or judicial remedy. [102]

Best practice 7:

- Countries should implement appropriate administrative measures to facilitate recourse to the MAP to resolve treaty-related disputes, recognising the general principle that the choice of remedies should remain with the taxpayer.[103]

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[102] OECD/G20 2015 Final Report on Action 14 in para 50.
[103] OECD/G20 2015 Final Report on Action 14 in para 51.

Best practice 8:

- Countries should include in their published MAP guidance an explanation of the relationship between the MAP and domestic law administrative and judicial remedies. Such public guidance should address, in particular, whether the competent authority considers itself to be legally bound to follow a domestic court decision in the MAP or whether the competent authority will not deviate from a domestic court decision as a matter of administrative policy or practice.

Best practice 9:

- Countries' published MAP guidance should provide that taxpayers will be allowed access to the MAP so that the competent authorities may resolve through consultation the double taxation that can arise in the case of bona fide taxpayer-initiated foreign adjustments – i.e. taxpayer-initiated adjustments permitted under the domestic laws of a treaty partner which allow a taxpayer under appropriate circumstances to amend a previously-filed tax return to adjust (i) the price for a transaction between associated enterprises or (ii) the profits attributable to a permanent establishment, with a view to reporting a result that is, in the view of the taxpayer, in accordance with the arm's length principle. For such purposes, a taxpayer-initiated foreign adjustment should be considered bona fide where it reflects the good faith effort of the taxpayer to report correctly the taxable income from a controlled transaction or the profits attributable to a permanent establishment and where the taxpayer has otherwise timely and properly fulfilled all of its obligations related to such taxable income or profits under the tax laws of the two Contracting States.

Best practice 10:

- Countries' published MAP guidance should provide guidance on the consideration of interest and penalties in the MAP.

Best practice 11:

- Countries' published MAP guidance should provide guidance on multilateral MAPs and advance pricing arrangements (APAs).

6.3 A FRAMEWORK FOR A MONITORING MECHANISM

The OECD came up with the following framework for implementing the minimum standards:

1) All OECD and G20 countries, as well as jurisdictions that commit to the minimum standard will undergo reviews of their implementation of the minimum standard. The reviews will evaluate the legal framework provided by a jurisdiction's tax treaties and domestic law and regulations, the jurisdiction's

MAP programme guidance and the implementation of the minimum standard in practice. [104]

2) The core output of the peer monitoring process will come in the form of a report.
3) The report will identify and describe the strengths and any shortcomings that exist and provide recommendations as to how the shortcomings might be addressed by the reviewed jurisdiction. The core documents for the peer monitoring process will be the *Terms of Reference* and the *Assessment Methodology*.
   - *The Terms of Reference:*
     - will be based on the elements of the minimum standard Report and will break down these elements into specific aspects against which jurisdictions' legal frameworks, MAP programme guidance and actual implementation of the minimum standard are assessed.
     - will provide a clear roadmap for the monitoring process and will thereby ensure that the assessment of all jurisdictions is consistent and complete.
   - *The Assessment Methodology:*
     - will establish detailed procedures and guidelines for peer monitoring of OECD and G20 countries and other committed jurisdictions by the FTA MAP Forum and will include a system for assessing the implementation of the minimum standard.
4) Both the *Terms of Reference* and the *Assessment Methodology* will be developed jointly by Working Party No. 1 and the FTA MAP Forum by the end of the first quarter of 2016.
5) The peer monitoring process conducted by the FTA MAP Forum, reporting to the G20 through the OECD Committee on Fiscal Affairs, will begin in 2016, with the objective of publishing the first reports by the end of 2017. [105]

6.4 COMMITMENT TO MANDATORY BINDING MAP ARBITRATION

The agreement to a minimum standard that will make tax treaty dispute resolution mechanisms more effective is complemented by the commitment, by a number of countries, to adopt mandatory binding arbitration. The OECD notes that the business community and a number of countries consider that mandatory binding arbitration is the best way of ensuring that tax treaty disputes are effectively resolved through MAP.

- There is however currently no consensus among all OECD and G20 countries on the adoption of mandatory binding arbitration as a mechanism to ensure the timely resolution of MAP cases.

[104] OECD/G20 2015 Final Report on Action 14 in paras 60-61.
[105] Ibid.

- However, a significant group of countries has committed to adopt and implement mandatory binding arbitration.[106] The countries that have expressed interest in doing so include Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States. The OECD notes that this represents a major step forward as together these countries are involved in more than 90 percent of outstanding MAP cases at the end of 2013, as reported to the OECD. [107]
- The OECD states that a mandatory binding MAP arbitration provision will be developed as part of the negotiation of the multilateral instrument envisaged by Action 15 the BEPS Action Plan.
- The countries in this group will, in particular, be required to consider how to reconcile their different views on the scope of the MAP arbitration provision. Whilst a number of the countries included in this group would prefer to have no limitations on the cases eligible for MAP arbitration, other countries would prefer that arbitration should be limited to an appropriately defined subset of MAP cases.[108]

7 OVERVIEW OF MAP FOR SOUTH AFRICA

The latest summary of treaties, on SARS website as at 21 July 2015, shows that South Africa has an extensive treaty network and has DTA's with 73 countries. In terms of section 108 of Income Tax Act read together with section 231 of the Constitution, a tax treaty becomes part of the Income Tax Act after it has been negotiated and published in the Government gazette.

Even though South Africa is a member of the OECD BEPS Committee and also a member of the G-20, adoption of the OECD recommendations such as those on MAP must take into consideration the special economic and socio geo-political circumstances of the country and its position on the African continent. For South Africa to determine the approach it will take with respect to Action 14, it has to consider its treaty partners and its stated economic policy to begin a gateway to foreign investment into Africa. A policy decision should be considered about the position to be taken regarding accepting the OECD and/or UN recommendations, where there are divergent approached or guidelines. Many African countries with source based tax systems prefer to sign treaties based on the UN MTC which is more favourable to source countries rather than the OECD Model that favours residence countries. Although MAP has not been very effective among African countries, many of them largely adopt the UN approaches to treaty issues such as the UN Transfer Pricing guidance.

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[106] OECD/G20 2015 Final Report on Action 14 in para 8.
[107] OECD/G20 2015 Final Report on Action 14 in para 62.
[108] OECD/G20 2015 Final Report on Action 14 in para 63.

The UN also issued a Guide to MAP under Tax treaties.[109] The Guide's primary focus is on the specific needs and concerns of developing countries and countries in transition, and would be instrumental for South Africa to follow in ensuring effective MAP. The UN Guide considers different possible ways to improve the MAP (including advance pricing agreements, mediation, conciliation, recommended administrative regulations and prescribed obligations) for the taxpayer applying for mutual agreement procedure. This UN capacity-building initiative seeks to provide countries that have little or no experience with the mutual agreement procedure with a practical guide to that procedure. Whilst this Guide draws on the OECD Manual on Effective Mutual Agreement Procedures (MEMAP), it is based on the provisions of the UN Model Double Taxation Convention between Developed and Developing Countries (update 2011) and seeks to present the various aspects of MAP from the perspective of countries that have limited experience with that procedure.[110]

The statistics of MAP cases for South Africa as listed on the OECD website for the period 2006-2014[111] is as follows

Year MAP case was initiated	Case with OECD Member country	Case with OECD Non-member country	Cases completed during reporting period (including cases carried over from previous year)	
			OECD country	Non-OECD country
2008	3	1	3	1
2009	1	0	0	0
2010	2	3	1	1
2011	1	4	0	3
2012	1	2	1	2
2013	1	1	2	0
2014	4	0	2	0

The above table shows that South Africa has participated in a minimal number of MAPs presumably because of taxpayers have not applied for MAP and also due to capacity issues. So the MAP process in South Africa is generally not that developed and there is a general lack of capacity and even capability to practically manage the MAP process. It appears that when an application for MAP is made to the competent authority, the application is referred back to the same audit team involved in the original dispute. This is clearly an issue of concern for taxpayers due to there being a risk of a lack of objectivity of the audit team.

There is also little awareness amongst South African multinational companies of the MAP process and the role played by SARS. The MAP process is supposed to be initiated by the taxpayer. However, since the process normally takes long, taxpayers

109 UN "Guide to Mutual Agreement Procedure in Tax Treaties" (2012). Available at http://www.un.org/esa/ffd/tax/gmap/Guide_MAP.pdf accessed 16 May 2014.

110 Ibid.

111 OECD "Mutual Agreement Procedure Statistics 2006-2014: South Africa". Available at http://www.oecd.org/ctp/dispute/map-statistics-2006-2014.htm accessed 4 April 2016.

often avoid initiating MAP. Nevertheless, MAP is likely to become increasingly important as more treaties are concluded with less developed countries and the process becomes more accessible and reliable.

Even though South Africa has a wide network of double tax treaties it has only 3 treaties which include binding arbitration clauses: These are the treaties with Canada, [112] Netherlands[113] and Switzerland.[114]

Treaty disputes can arise as a result of overly complex CFC rules, interest deductibility rules which are difficult to administer and enforce for SARS and problematic for taxpayers to comply with. Most disputes that require MAPs relate to transfer pricing disputes. However in South Africa, the Transfer Pricing Draft Interpretation Note issued by the SARS exacerbates the feeling of uncertainty for taxpayers. Clear guidance is required in order to provide taxpayers with certainty, which is a fundamental cornerstone for the encouragement of greater cross-border investment into a country. These concerns are further augmented by the fact that South Africa does not have an Advance Pricing Agreement (APA) programme in place, which is usually beneficial in preventing transfer pricing disputes. Bilateral APAs provide an increased level of certainty for taxpayers. Thus lack of APAs in South Africa could inhibit foreign direct investment into South Africa.

8 RECOMMENDATIONS ON MAP FOR SOUTH AFRICA

- South Africa should adopt the OECD minimum standards with respect to MAP.

- SARS needs to be more active in supporting South African taxpayers during MAP processes. This is especially so in treaties involving African countries where the MAP process is not developed and is not effectively applied. A critical need in this regard relates to cases where some African countries incorrectly claim source jurisdiction on services (especially management services) rendered abroad and yet those services should be considered to be from a South African source. These countries levy withholding taxes from amounts received by South African residents in respect of services rendered in South Africa. The withholding taxes are sometimes imposed even if a treaty

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112 SARS "Convention Between The Republic of South Africa and Canada For The Avoidance of Double Taxation And The Prevention Of Fiscal Evasion With Respect to Taxes on Income" Government Gazette No. 17985, Date of entry into force 30 April 1997.

113 SARS "Convention Between The Republic Of South Africa And The Kingdom Of The Netherlands For The Avoidance Of Double Taxation And The Prevention Of Fiscal Evasion With Respect To Taxes On Income And On Capital" Government Gazette No. 31797, Date of entry into force 28 December 2008.

114 SARS "Convention Between The Republic Of South Africa And The Swiss Confederation For The Avoidance Of Double Taxation With Respect To Taxes On Income" Government Gazette No. 31967, Date of entry into force 27 January 2009

between South Africa and the relevant country does not have an article dealing with management fees or and even if South African residents do not have permanent establishments in these countries. In response to the double taxation concerns that South African taxpayers face and to encourage investors to see South Africa as an attractive headquarter location, National Treasury enacted section 6*quin* which provides a rebate for management fees and technical service fees even though use of MAP in double tax treaties is the right forum that should have been employed to resolve these concerns. However South Africa residents had little success in challenging these matters with the tax authorities of the other countries and yet SARS was also not able to enforce the proper application of the treaties with these countries.[115] Although section 6*quin* ensured that South African taxpayers are not subjected to double taxation,[116] its application implied that South Africa had departed from the tax treaty principles in the OECD MTC in its treaties with the relevant countries, in that it has given them taxing rights over income not sourced in those countries. As a result, South Africa effectively eroded its own tax base as it is obliged to give credit for taxes levied in the paying country. In terms of 2015 Taxation Laws Amendment Act, National Treasury repeal of section 6*quin* from years commencing on or after 1 January 2016.[117] National Treasury explains that South Africa is the only country with a provision (like s 6*quin*) which goes against international tax and tax treaty principles in that it indirectly subsidises countries that do not comply with tax treaties and that it is a compliance burden for SARS. National Treasury also had concerns that some taxpayers were abusing the relief offered by the section. As noted above MAP under tax treaties is the forum that ought to be used to solve such problems. As a member of the African Tax Administration Forum (ATAF) which promotes and facilitates mutual cooperation among African tax administrators), South Africa should strongly advocate for ATAF to ensure that member countries enforce their treaty obligations and ensure that taxpayers can access MAP.

- To ensure the effectiveness of MAP it is important that the performance measures against which officials working on MAP are measured should not be based on factors such as revenue obtained. Such officials should have a different reporting structure to that of the SARS audit team, because of the fact that, in a MAP case, a portion of tax will inevitably be given up by the competent authority. This is highlighted in the OECD Final report on Action 14 which provides that "countries should not use performance indicators for their competent authority functions and staff in charge of MAP processes based on the amount of sustained audit adjustments or maintaining tax revenue".[118]

115 PWC "Comments on DTC BEPS First Interim Report" (30 March 2015) at 22.
116 Ibid.
117 Section 5 of the Draft Taxation Laws Amendment Bill 2015.
118 OECD/G20 2015 Final Report on Action 14 in para 28.

- To ensure the effectiveness of MAP, when an application for MAP is made, it must be referred to an independent and separate unit that deals with MAP, not to e.g. the transfer pricing audit unit. This is in line with the OECD recommendation on Action 14 which states that "countries should ensure that the staff in charge of MAP processes have the authority to resolve MAP cases in accordance with the terms of the applicable tax treaty, in particular without being dependent on the approval or the direction of the tax administration personnel who made the adjustments at issue or being influenced by considerations of the policy that the country would like to see reflected in future amendments to the treaty."[119]

  We acknowledge that it is not every SARS transfer pricing auditor who may be affected by their lack of independence if presented with a MAP matter, and we also acknowledge the difficulty in achieving this complete separation as the officials involved will need to be chosen from a relatively small pool of appropriately skilled people, however, this is a crucial step not only to ensure the effectiveness of MAP, but also to obtain the co-operation and trust of taxpayers. The same level of independence should exist between the audit teams and the teams considering APA's similar to the current separation between audit and advanced rulings.

- Although the SARS transfer pricing team has grown significantly in both size and expertise, there remain significant constraints due to the lack of skilled resources in South Africa. It is therefore important that attention must be given to intensive recruitment and robust training of personnel by SARS. This will, in turn, clearly require that funding be made available. A lack of sufficient resources (whether staff, training, funding, etc.) will inevitably result in unsatisfactory outcomes and a backlog of cases due to delays by the competent authority in processing such cases. Outsourcing could possibly be considered as a temporary solution.

- It is important for South Africa to include Article 9(2) in those DTAs where it has not yet been included. This is to ensure that the position in the South African treaties are in accordance with the commentary on Article 25. This is, however, not a "deal breaker" as Article 25(3) in any event permits discussions between the respective competent authorities in situations of double taxation not covered by the DTA. Secondary adjustments, for interest and penalties should be dealt with under the MAP process simultaneously. Further, interest to be levied in relation to a period of time caused by an unreasonable delay in either the domestic process or the MAP process, could

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[119] OECD/G20 2015 Final Report on Action 14 in para 27.

be waived subject to SARS' discretion and potentially align to a suspension of payment.

- SARS should not influence taxpayers to waive the right to MAP not should taxpayers be prohibited, as part of settlement negotiations, from escalating the portion of tax suffered to the competent authority for relief from double taxation. This would amount to a unilateral decision, without due regard to the spirit of the double tax treaties or the treaty partner.

- Advance pricing agreements (APAs) lessen the likelihood of transfer pricing disputes. Lack of an APA program in South Africa is an inhibitor to foreign direct investment as it removes the opportunity to seek certainty on transactional pricing, particularly when Multinationals expand into the rest of Africa. It is acknowledged that there are scarce resources within the transfer pricing arena to enable a separate and independent unit to deal with APA's. A possible temporary measure could be to outsource this to recognised experts with oversight by senior SARS officials. When APA are adopted, consideration should be given to the possibility of combining MAP proceedings for a recurring transfer pricing issue with a bilateral APA with rollback. This would be in line with the OECD recommendation that "countries with bilateral advance pricing arrangement (APA) programmes should provide for the roll-back of APAs in appropriate cases, subject to the applicable time limits (such as statutes of limitation for assessment) where the relevant facts and circumstances in the earlier tax years are the same and subject to the verification of these facts and circumstances on audit".[120]

- Although South Africa has guidelines and regulations on domestic dispute resolution and litigation, there is no guidance on how to resolve disputes through the treaties. There is confusion as to how SARS approaches this, who the appropriate competent authority is and how the process should be followed. For instance some countries will suspend domestic resolution processes pending the outcome of a MAP appeal whereas other countries require the domestic remedies to be exhausted before entertaining a MAP appeal. Clear guidance on when SARS will entertain MAP needs to be given together with an appropriate process guide for taxpayers similar to the guide issued for domestic resolution. Such guidance should be clear and transparent, not unduly complex and appropriate measures should be taken to make such guidance available to taxpayers. The Guidance should contain information such as:
  - When will MAP be applied;
  - Applicable time limits in which a taxpayer can approach the Competent Authority;

[120] OECD/G20 2015 Final Report on Action 14 in para 33.

- Who the Competent Authority is;
- What documents are required to be submitted with any application for MAP;
- Interaction of MAP with domestic legislation;
- Estimated timelines; and
- Liabilities of the Competent Authority.

For purpose of providing examples to which South Africa could refer when drafting such guidance, reference could be had to:
- The HMRC's "*Statement of Practice, SP1/11*";
- The "*Mutual Agreement Procedures (MAP) Operational Guidance for Member Countries of the Pacific Association of Tax Administrators (PATA"),*[121]
- The OECD "*Manual on Effective Mutual Agreement Procedures" ("MEMAP")* ; and
- The UN "*Guide to the Mutual Agreement Procedure under tax treaties*":

- ➢ Since most disputes concern transfer pricing, it is important that SARS Interpretation Note on Transfer Pricing is finalised. Clear guidance should also be provided with respect to thin capitalisation rules. Other MAP disputes relating to controlled foreign company rules (CFC) and interest deductibility could be prevented by simplifying the complex CFC rules and the interest deductibility provisions.

- ➢ The current audit procedure in South Africa includes two aspects of an enquiry, a risk assessment process which is to determine whether an audit is warranted, and a full audit process. The roles and responsibilities of these two are becoming blurred in certain circumstances which places the taxpayer in a position of uncertainty as to whether the matter is under audit or not. The respective roles and responsibilities therefore need clarifying and SARS should be required to inform the taxpayer as to whether their matter is under audit or not. Further the audit process often creates problems for taxpayers in that SARS often requires extremely detailed information from a taxpayer, in a relatively short period of time, without any timeline or time commitment being placed on SARS to respond resulting in an unreasonably long time passing, this needs to be addressed through better audit governance measures.

- ➢ The timing for applying for MAP needs to be clarified. Under Article 25(1) of the OECD UN MTC where a person considers that the actions of one or both contracting states results or will result in taxation that is not accordance with the provisions of the treaty, that person may irrespective of any remedies available under domestic law, present his case to the competent authorities of

[121] PATA is an inter-country affiliation between Australia, USA, Canada and Japan.

the contracting states in which he is resident (or the state in which he is a national). The case has to be brought to the attention of the competent authorities within three years from the first notification that the relevant tax is not in accordance with the provisions of the treaty. In South Africa, the timing is not clear and it appears that that the domestic rules govern the process and acceptance of such applications. It is understood that with scarce resources it would be inefficient to entertain a domestic appeal and competent authority application simultaneously. SARS needs to clarify the time when it will entertain a competent authority application, that is, whether it is once the taxpayer's objection has been disallowed, or at the same time as the appeal. This needs to be clarified in some form of binding, written communication. In this regard, it is recommended that SARS keeps to the two year time limit as is recommended in the OECD Commentary on Article 25(1). Further, to the extent the domestic appeal is suspended pending the outcome of the MAP, this should be clearly stated in the guidance, together with advice on payment suspension. The UK's clarification on this matter can be emulated, as set out in the HMRC's Statement of Practice 1, 2011. Paragraph 21 thereof states: "*The UK follows the approach adopted by most countries and described in the Commentary on Article 25 at Paragraph 76. Under this approach a person cannot pursue simultaneously the MAP and domestic legal remedies. Thus a case may be presented and accepted for MAP while the domestic remedies are still available. In such cases, the UK competent authority will generally require that the taxpayer agrees to the suspension of these remedies or, if the taxpayer does not agree, will delay the MAP until these remedies are exhausted."*

In Australia, the Australian Taxation Office ("ATO") considers concurrently a case presented to the competent authority and the objection lodged by the taxpayer under domestic provisions.

- In relation to the "Pay now, argue later" principle currently applied by the SARS, if a MAP matter take years before being resolved, SARS should be cognisant of the fact that not permitting the suspension of payment pending the outcome of MAP can be extremely detrimental to the taxpayer. The OECD recommended best practice on Action 14 to ensure taxpayers can access MAP, is that countries should take appropriate measures to provide for a suspension of collections procedures during the period a MAP case is pending. Such a suspension of collections should be available, at a minimum, under the same conditions as apply to a person pursuing a domestic administrative or judicial remedy. [122] This recommendation should be followed in South Africa. The UK example could be emulated. In the UK, a taxpayer

[122] OECD/G20 2015 Final Report on Action 14 in para 50.

may apply to the HMRC to defer the payment.[123] In the UK, each case is decided on its own merits, with consideration of factors including, but not limited to, the size of the tax liability, the capacity of the taxpayer to discharge the tax liability and the risks to the revenue. Deferral may be subject to review on a periodic basis, a requirement for partial payment, the provision of security by the taxpayer, or other such arrangements which minimise the risk to the revenue authority. It is recommended that measures such as those in the UK should be adopted in South Africa.

- Many developing countries, do not consider themselves yet ready for mandatory binding arbitration in the international taxation context. India and Brazil made it clear in the BEPS discussions on the matter that they would not be involved in binding mandatory arbitration.[124] Developing countries are very wary of adopting binding arbitration provisions in their tax treaties, since normally in arbitration cases the winning country gets the tax revenue and the other loses. Mandatory binding arbitration is considered unfair since it entails entrusting decisions involving often millions of dollars to a secret and unaccountable procedure of third party adjudication. Developing countries hold the view that arbitration can only be effective and accepted if the rules to be applied are clear, and if the procedures are open and transparent, including the publication of reasoned decisions. As a developing country, these matters should be of concern to South Africa too. For that matter, South Africa should call for measures to be in place to make the arbitration process more transparent and it should it only commit to the process if the rules are clear and transparent. Until the MAP arbitration process is made more transparent, South Africa should also be cautious about committing to an arbitration provision in the envisaged Multilateral Instrument under Action 15 of the OECD BEPS Action Plan. When South African becomes a party to the Multilateral Instrument, it should register a reservation not to commit to mandatory arbitration until the concerns regarding this process are rectified.

- Since mandatory arbitration is viewed by the OECD and taxpayers as a means of speedily resolving MAP, South Africa should call for international measures to be put in place to ensure transparency in the arbitration procedures:
  - South Africa should join the call for an international panel of arbitrators, for instance under the auspicious of the United Nations to be formed that comprises a panel of members from both developing and developed countries. Decisions of such a panel would be considered neutral and fair to the interests of all countries.

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123 HMRC Taxation Ruling TR 2000/16, paragraphs 4.50 – 4.51

124 UN Committee of Experts on International Cooperation in Tax Matters "Secretariat Paper on Alternative Dispute Resolution in Taxation" (8 October 2015) in para 21.

- At regional level, South Africa should recommend that a pool of arbitrators be formed, with the necessary skills and qualifications, from among ATAF member countries. The ATAF member countries could then draw on arbitrators from that pool in cases where the MAP was between two ATAF-member countries. We note in this regard that a similar idea is successfully implemented under the EU Arbitration Convention, which pool comprises a pool of arbitrators appointed from EU member states.
- South Africa should call for MAP results and agreements reached (even the “anonymised” versions) to be published annually (this could be in redacted form – removing matters that are confidentiality concern) – this will provide further guidance and proactively resolve other potential future disputes.
- Exchange of existing best practices between SARS and other revenue authorities should be strongly encouraged. South Africa should in particular adopt the OECD recommendation regarding Best Practice 1 (inclusion of Article 9(2) in its tax treaties); Best Practice 2 (adopt appropriate procedures to publish MAP agreements reached); Best Practice 5 (implement procedures that permit, after an initial tax assessment, taxpayer requests for the multiyear resolution through the MAP of recurring issues with respect to filed tax years, where the relevant facts and circumstances are the same); Best practice 6 (take appropriate measures to provide for a suspension of collections procedures during the period a MAP case is pending); Best Practice 7 (take appropriate measures to provide for a suspension of collections procedures during the period a MAP case is pending); Best Practice 8 (published MAP guidance explaining the relationship between the MAP and domestic law administrative and judicial remedies); Best Practice 9 (publish MAP Guidance which provides that taxpayers will be allowed access to the MAP where double taxation arises in the case of bona fide taxpayer-initiated foreign adjustments permitted under the domestic laws of a treaty partner); Best Practice 10 (publish guidance on the consideration of interest and penalties in the MAP).